ANTITRUST MODERNIZATION COMMISSION

PUBLIC HEARING

Thursday, November 17, 2005

Federal Trade Commission Conference Center
601 New Jersey Avenue, N.W.
Washington, D.C.

The meeting convened, pursuant to notice at 9:43 a.m.

PRESENT:

DEBORAH A. GARZA, Chairperson
JONATHAN R. YAROWSKY, Vice Chair
BOBBY R. BURCHFIELD, Commissioner
W. STEPHEN CANNON, Commissioner
DENNIS W. CARLTON, Commissioner
MAKAN DELRAHIM, Commissioner
JONATHAN M. JACOBSON, Commissioner
DONALD G. KEMPF, JR., Commissioner
SANFORD LITVACK, Commissioner
DEBRA A. VALENTINE, Commissioner
JOHN L. WARDEN, Commissioner

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ALSO PRESENT:

ANDREW J. HEIMERT, Executive Director
and General Counsel
WILLIAM F. ADKINSON, JR., Counsel
TODD ANDERSON, Counsel
MICHAEL KLASS, Economist
HIRAM ANDREWS, Law Clerk
KRISTEN M. GORZELANY, Paralegal

These proceedings were professionally transcribed by a court reporter. The transcript has been edited by AMC staff for punctuation, spelling, and clarity, and each witness has been given an opportunity to clarify or correct his/her testimony.

C O N T E N T S

P R O C E E D I N G S

CHAIRPERSON GARZA: Let's open the hearing, the Antitrust Modernization Commission hearing, on the Assessment of U.S. Merger Enforcement Policy.

Thank you, gentlemen, for agreeing to be here today to take our questions, and for your written testimony.

I wanted to explain really briefly how we will proceed this morning. We'll begin by giving each of you an opportunity, actually a 5-minute opportunity, to briefly summarize your written testimony. When you have done that, then we will begin with the Commissioners' questioning. Our practice is to have one of the Commissioners lead the questioning, and in today's case, that will be me. So I will take about 20 minutes or so for an initial round of questioning. Following that, each of the Commissioners will have 5 minutes each to put questions to the panelists, and because we have a full complement of Commissioners we will be trying to more strictly enforce that 5-minute limit than we have in the recent past in order to ensure that

everybody gets adequate time for questioning.

So with that, let me begin, and we will start from Mr. Willig and go to my right, if you would like to briefly summarize your testimony.

MR. WILLIG: Thank you very much. Let me ask you, as a preliminary question, are we serious about 5 minutes?

CHAIRPERSON GARZA: Yes. I am unlikely to be so rude as to interrupt you midstream--

COMMISSIONER VALENTINE: That's why we told you you should have sent it earlier.

[Laughter.]

MR. WILLIG: Well, luckily, it's very logically fashioned, so therefore it's subject to ready condensation.

I say good morning to you. I hope the clock is stopped for salutations.

CHAIRPERSON GARZA: Let me just interrupt you one second. To aid you, we have some boxes on each of the tables with green, yellow, and red. When it's in yellow it means you're getting close. When it's red then we ask you to try to wrap it up.

MR. WILLIG: Okay. Is the clock still

stopped now?

COMMISSIONER KEMPF: We're going to restart.

MR. WILLIG: Thank you very much. I appreciate that.

COMMISSIONER KEMPF: We're only going to restart three or four times.

[Laughter.]

MR. WILLIG: I thank you once again, and once again I bid you good morning on this lovely day here in the nation's capital, and I really do welcome the opportunity, and am very pleased to share my views with you on U.S. merger enforcement policy.

Overall, I have an easy conclusion to share with you, and that is that the conduct and the practice of antitrust analysis of mergers here has evolved into an intelligent design, and I wondered if that was too sensitive a characterization for our times, but I actually think it hits it right on the head.

The current structure of antitrust that we have before us today has adapted very well to the really enormous changes of the recent past, say, the last 20, 25 years, and the changes that I am thinking

about are dramatic changes in the economy, both on the side of technology and also on the side of consumer demand, and also from a more parochial view, but a view that I think has become quite important to antitrust generally, enormous changes in our economic understanding of the economy. I think those changes in our economic understanding have come not just from the actual changes in the real economy but also in the progress of thinking about competition.

Interestingly, those changes have come not just from economists, but also from the entire community of competition policy thinkers. That goes quite a bit more broadly than just economists. I'm talking about lawyers, folks like yourselves, and practitioners in competition policy. This community has been instrumental, I believe, in pushing out the boundaries of economics and our understanding, and I think that the framework for antitrust merger analysis that we have is flexible enough and conceptually sound enough to accommodate the needed adaptations to changes in the economy and changes in our thinking about the economy.

I wanted to focus today, in the very short

time remaining, on the question of market definition, and also on the use of concentration measures, which goes along with market definition. The reason that I pick on this today is that I'm aware of very sound voices from those who are smart practitioners, wise observers of the antitrust scene, who suggest that it's time to jettison the requirement in law and policy that we define relevant markets and conduct our analyses therein to show that competition would be diminished by a merger as a prelude, as a requirement before there is intervention.

There is plenty of motion from wise people to jettison that requirement and call market definition obsolete. That's not my view, and it's a considered view--because it would be fun to jump onto a band wagon that says, "Let's be progressive thinkers; let's get rid of the imperfect old ways." It would be fun to act in such a progressive fashion, but I actually think that wisdom--maybe it comes with old age--but I think it's fresh wisdom as well, that the process of market definition is a much-needed discipline that hems in our ability to allow ourselves to intervene in markets to stop mergers,

and it's a very reliable form of discipline.

In my paper--and I welcome your questions on it--I talk about an example of lines--of circumstances where it really makes a difference that we do force ourselves to undertake the step of market definition so as to cut off unreliable perspectives that would come from more direct assessment of market power.

At the same time, I am well aware that there are direct methods of analysis of market power that are very attractive, and that, when and where they are available, they can be much more reliable than the traditional approach of first defining a relevant market and then proceeding to ask ourselves whether the merger would have a substantial impact on concentration within that relevant market.

My answer to that is that the particularly informative methods that are sometimes available, like natural experiments--for example, in an *Office Depot/Staples* kind of circumstance, not to embrace the facts of that case, but as a representation of a class of cases where such natural experiments are available--they should be used as the source of best

evidence for our conclusions about the merger, and also for our conclusions about market definition. The same evidence that told the court and was accepted by the court that that merger would indeed raise prices is the very same evidence that we should be willing to accept to show that the relevant market there was confined to super stores despite other forms of evidence that might have pointed to a different conclusion.

If one says that market definition should be a requirement and the decision about market definition should be based on best evidence, where best evidence permits natural experiments and other forms of analysis to be acceptable in reaching conclusions about market definition, then I think we have the best of both worlds, and I think that's the way we should proceed as a community.

The light is red.

CHAIRPERSON GARZA: Thank you. Hopefully, some of the questioning will let you get out some of your other ideas.

MR. WILLIG: Thank you very much.

CHAIRPERSON GARZA: Mr. Scheffman?

MR. SCHEFFMAN: Thank you, Chairman. Let me use a little of my scarce moments I have. One, I am impressed to be included among such an august panel, and want to spend a little time, because I've criticized Jim and Bobby in the past about the '92 guidelines. Let me be clear. Jim Rill, in my view, along with Bill Baxter, was the leading AAG for merger enforcement that we have had in our time, and he pioneered what we have now, a lot of international cooperation, and an attempt to move toward some convergence.

Bobby, when he was appointed Deputy AAG, I said, on the merits was clearly the most impressive appointment we had ever had in that position, and I think his contributions to the '92 Guidelines and everything still make him perhaps my candidate for the leading contributor to that position.

Bill Baer--you know, I worked for Tim Muris, and it was a different time--but I would certainly say Bill and Tim Muris, and probably Kevin Arquit, were certainly the leading Directors of the Bureau of Competition on merger enforcement in our times, so let me clarify that.

Why am I on this panel? One reason perhaps is that I have had some experience in mergers. I've been at the Agency, I guess, longer than anyone else on the panel. I think my perspective's unique in that I've spent the last 15 years as a business strategy professor, marketing professor, and business consultant, and that informs my opinion about how I look at antitrust and mergers in particular. Let me make a few quick comments.

Let's not lose sight of that the change in policy in the '80s was absolutely important and undoubtedly procompetitive. As I say in my statement, the merger I was analyzing in the early 1980s at the FTC when I got there was Exxon's acquisition of Reliance. That was the biggest merger we were looking at. That was neither a horizontal nor a vertical merger. It was stupid, and no one would look at a transaction like that these days. But in those days there weren't "any" horizontal mergers, because people realized you couldn't actually do a horizontal merger, because of anti-merger enforcement.

The 1980s was a period of profound

revitalization of the U.S. economy. It provided the basis for where we are now and why we lead the world in the productivity of our economy. The change in merger policy was not the sole cause of that, but it was certainly a significant facilitating factor. I've written and testified about that in Congress in the past.

So the change has been good, as I indicated in my statement. The change has been positive. Merger enforcement has continued over time to become even better, more sensible, make less mistakes, benefited consumers and benefited the competitiveness of the American economy, and for consumers generally.

What does merger enforcement get right? Customer opinions are really--other than if you got really "hot docs," customer opinions are the things the agencies rely on the most. I think that's good when they're representative opinions of sophisticated customers. But we've learned, and the agencies have learned, in cases like *Arch* and *Oracle*, that they're not *the* answer to a fact finder making a decision. So the agencies are rethinking the role of customer opinions. I've said customer opinions are very

important, but they're not a substitute for solid market definition or competitive effects analyses.

But when you do have *representative* opinions, as I spell out in my written remarks, they're the proper basis, I think, for lots of business and economic and antitrust reasons. It's quite appropriate for the antitrust agencies to rely on that, and they will win in court as they should.

I think the further you get away from that situation, the more problems we have in enforcement, in my view, and I've been in enforcement for a long time. In my view, the mistakes are predominantly on the side of blocking or interfering with mergers that probably are not problematic, and we're groping still. And as I said, the error rate is not high, but there is an error rate, and corrections could be made. The problems I identify in my written statement--it's a very legalistic environment we have here with really no discovery by the parties until you go to court. It's not unusual for the agencies, for the case they bring in court, to be markedly different than the case that the parties thought they were facing in the investigation. There are a lot of

reasons for that.

There's not any reason in the world I can think of for not allowing for more transparency by the agencies. In my experience at the FTC, when we had transparency, the staff's job was almost always easier, because they knew, and they said, "Here's what we have. What's your answer?" And usually there wasn't an answer that came back, so they knew that they didn't have to worry about that, and they're sound in their case.

I think transparency is very important. I think the abuse of the remedy process is not as bad as it used to be, but there is still too much micro-managing and not really getting competitive relief, micro-managing the business of the divestiture.

I agree entirely with Bobby Willig on market definition. It is the biggest problem for the agencies. The agencies, in fact, within their internal investigations, often do not do what they need to in an investigation to nail down market definition, and then when they do get into court, they get into problems like in *Oracle* and *Arch*.

Finally, a point on economic analysis, that

I cover in more detail in my written remarks. As a business strategy professor I started out as an economist; I am an economist. But I think that it's time for economics to converge with the reality we see, and have models that actually replicate what we see. Not that the models we don't have aren't informative and useful, but they are not a substitute for fact-based theory. Thank you.

CHAIRPERSON GARZA: Thank you.

Mr. Rill?

MR. RILL: Thank you very much, Madam Chair, and thank you, Commissioners, for the opportunity to appear. I may be a little slower in talking than Bobby and David, so count it for age.

The two questions that I'll address are the two first questions that were put by the Commission, and that is, is the current merger enforcement regime on the right track? Is it correct—-are the guidelines a proper framework for analysis of mergers? And I would give you a dynamic but not static answer, and the dynamic answer is yes and yes. We need to go back nearly 40 years to look at the history of the Merger Guidelines and what I think an

increasing number of people recognize is that the Turner Guidelines of 1968 were themselves an advance forward in legal thinking, and possibly even economic thinking from the cases that Don Turner was turning his back on, such as *Vons*, *Pabst/Blatz* and the like.

The Baxter Guidelines in 1982 are the real watershed of merger enforcement. They have set the pattern ever since for horizontal merger enforcement, which makes Bill Baxter--thank you very much, David--but Bill Baxter is head and shoulders above all of the rest of us, with all respect, in the development of a sound merger policy. Interestingly, if you look at some of the work by Tom Leary and Tim Muris and others, Bill Kovacic, the continuity of enforcement, horizontal merger enforcement, since the Baxter Guidelines has been almost on a straight line, with differences in administrations trembling only slightly around the margins.

The 1992 Guidelines, which Bill Baxter always referred to, somewhat to my chagrin, as the "Willig Guidelines", were--the rest of us really did work on that, I think did accomplish several advances, particularly in the fact that--don't forget

that they were the first joint guidelines ever issued by the DOJ and the FTC.

Prior to that time there had been, I think, a somewhat less than satisfactory statement out of the FTC at the time of the '82 Guidelines. And there was a further erosion of the determinative importance of concentration and the focus on competitive defects in the '92 Guidelines.

Since then there's been widespread acceptance of the guidelines. The court references are cited in the paper. Principally, since 1997 alone, virtually every court looks to the Guidelines with acceptance in dealing with horizontal mergers, which is quite a ways from 1992--I remember when we announced the 1992 Guidelines, Judge Thomas Penfield Jackson took the platform at the ABA spring meeting and said he would view them only as a statement against interest by the Government. We've come a long way, baby, since that.

In addition, they've been accepted internationally. When we were working on the '92 Guidelines, the Canadian people were working with us. They've been accepted generally, at least in

framework, in Europe now and are reaching across the world through the ICN.

I think that the Guidelines follow a paradigm that was set out by Tim Muris in his George Mason speech in 2003. They are clear. They are based on sound fundamental legal and economic principles, and they're flexible enough to advance with the thinking of--legal and economic thinking of the present, as this developed soundly. They have a high passing grade in connection with the Muris paradigm and with the questions asked by this Commission.

I think we are going to end up four for four in this panel in favor of preserving the market definition segment of the Guidelines. I think, for one thing, they have been accepted--by the way, let's look at the statute. It does have these words "line of commerce" in there, which may set a pattern for the following of a product market analysis, but more importantly, they're the best means of identifying all the firms in the market, and lead to a screen for concentration as well as for the players in the market.

The simulation option is not ready for prime time. One need only to look at the work Ken Heyer cited, footnote 21 of the paper, Bobby Willig's statement at the FTC/DOJ merger panel. They are so uncertain they need work between the parties and the agencies. Commissioner Carlton, with all respect, you said, "I like it," but there are big red flags out there that could lead to great error, and I refer you also to Dave Scheffman's written statement this morning on the value of product market definition and the Guidelines.

I also, just very quickly, want to say that the concentration presumption was very much weakened by the '92 Guidelines and subsequent developments. If one looks at the FTC report on horizontal merger investigations and enforcement--you can see Bill Baer cites this in his paper--general market data, Herfindahl's between 2,000 and 2,500, deltas between 300 and 500, cases investigated, something like 3 out of 17 cases that were investigated were brought in that area. And that analysis was relied on by the district court in the *Arch Coal* case.

With customer testimony and competitive

effects, I think one needs to rely heavily on the word "informed" customer testimony. Chairman Majoras again extolled the virtues of customer testimony in her ABA speech this week, but I think one needs to look at actual experience, actual documents, actual bid market analysis, to see whether or not there really is a lessening of options in the competitive sense available to the customer.

The rest of it is really in my paper, and I would conclude by saying that that is a continued flexible application of the Guidelines by the economic community, the legal community and the courts. I would make three recommendations: One is more transparency, and in this instance I would like to endorse very strongly the initiative announced by Chairman Majoras and endorsed also by Acting Assistant Attorney General Barnett, that there be the implementation program, which now is about ready, as I understand it, to be released, to give more insight into how the agencies actually internally administer the guidelines. I think that's an important transparency initiative. I think Bill Baer and others started explaining in great detail--when cases

weren't brought, as well as when we--what the theory was behind the underlying cases. And finally, I think that the cooperative effort, endorsed by Bobby Willig, between the Bar and the agencies and the economic community on simulation and on efficiencies would be a very positive program that could be endorsed by this Commission, with all respect.

Legislation in the merger area, please, no. I think things are working. They're working well. They're working well in progress, and I think within the limits of the suggestions I make and are made by others, I'll go back to my yes and yes response to the questions that you have raised, Commissioners.

Thank you.

CHAIRPERSON GARZA: Thank you.

Mr. Baer?

MR. BAER: Thank you, Madam Chair. And thank you for the opportunity to appear. I know my co-panelists and I salute you all and your staff for the tremendous public service you're performing here. It's hard to think of a more important and less remunerative contribution than the one you're making here.

You have my prepared statement. I thought I would highlight just a couple of points from a perspective of one who's had some recent enforcement experience inside the agency as well as outside. There is an odor of tacit collusion to the four remarks you've gotten from us, that we seem to come out, whether we talked in advance or not, that the current enforcement program seems to be working pretty well, and that is due, as Jim and others have noted, to the Merger Guidelines.

We have a more analytically sound system, I think, that results in the agencies doing a better job of asking the right questions. While I was there in the late '90s I was impressed by the way in which there is a better internal discipline about how you look at a merger, how you ask the tough questions, and how the staff, their superiors, and the Commissioners were focusing on the same things. That helped make I think for a better internal debate about whether a merger was problematic or not.

But the Guidelines serve the benefit of providing a framework for the business community and the antitrust advisers as well. On the front end we

can make, I think, a better-informed decision about whether a transaction is likely to run into problems or not based on the way the Guidelines have been expressed and applied, and knowing in advance, before you go into the agency, which questions are going to be addressed allows us as lawyers and economists to join the debate much better than when I was at the Federal Trade Commission years and years ago on my first tour of duty, or early on after the adoption of the initial set of Guidelines in '82.

So I think it basically works well. We all have our quarrels with respect to particular enforcement decisions. You know, we don't think the Guidelines were applied right, or we think facts may have been ignored that should have been weighted more heavily, but at least we're focused on a common set of questions, and that makes, I think, over the long term for a better debate, and I am impressed by the quality of it.

I'm impressed as well by the relative continuity we've seen over the years, even as enforcers and party affiliations have changed.

Jim, in his remarks, also makes the point

that judicial acceptance of the Guidelines is another significant positive step, and it has taken some time. Early on, there was some uncertainty about whether and how they ought to be applied and some hostility expressed by certain courts, but we've reached a point now where the Guidelines are a key source of judicial analysis of merger enforcement challenges, and that is a very healthy thing. Again, we can quarrel with application, but the courts increasingly are speaking the same language as the agencies, and that's a helpful fact; it helps promote stability.

A point I make in my paper, and I want to mention it just briefly, is that the fact that we, as a matter of U.S. policy, are more settled in our view of what constitutes sound enforcement, has real international benefits, benefits that are growing, and we've seen a proliferation of competition enforcement around the world, including a tremendous proliferation of merger notification regimes, but the fact that we have a consensus on how we look at things lets us, lets people like Jim Rill, go over to Japan, go over to Europe as AAG and help promote--

help move, rather, toward more consistent application of merger policy.

You've seen a number of national entities that have adopted the substantial lessening of competition standard. The fact that we are in agreement on how that standard is applied through the Merger Guidelines allows us to have a better dialogue and to encourage other agencies, particularly the European Commission, to approach things in a way that is similar and to reduce the frequency of outcomes that are divergent between us and other enforcement agencies.

All of that leads me to the bottom-line view that I don't think we need major overhaul to our system, and I worry that recommending and implementing significant change might be worse than living with whatever imperfections we see in our current system. That admittedly, and for me, arguably unique conservative view, is informed in large part by how long it took the agencies to get comfortable with the Guidelines, for the courts and the parties to get comfortable with them, and for the international community to accept U.S. merger

approaches as analytically sound. There is sort of a Tower of Babel risk, I think, in making changes to the language we speak. It takes a long time for that to settle down.

So as I conclude in my testimony, there is no--our system is not perfect. We can do a better job on lots of issues. You have already had a panel on clearance. Transparency is moving in the right direction. We can do more, particularly in the economic area. You will hear a lot later today about second-request prudence. But those changes or imperfections, the need for changes, really are at the margins. In my view, merger enforcement has become increasingly predictable, transparent, and analytically sound.

Thank you.

CHAIRPERSON GARZA: Thank you. Each of you has essentially answered the Commission's first question in the affirmative, that is, you believe current U.S. enforcement policies ensure competitively operating markets without unduly hampering the ability of companies to operate efficiently and compete in global markets.

Notwithstanding this happy consensus within the antitrust bar enforcement community, we still feel some rumblings from time to time from outside our little circle about whether or not merger enforcement is right.

Just this week, for example, I happened to see something from Jack Kemp that said that--he was complaining that merger policy was completely wrong. He also said, of course, that Justice had a monopoly on antitrust, which is a little hard to understand. At the same time, the *Wall Street Journal* recently had an editorial railing about merger enforcement policy. At the same time, this morning I happened to turn on the television to watch Don Imus and heard Donald Trump say, "I know business, and I don't understand why more mergers aren't being stopped, and who's the person who let Exxon and Mobil merge?"

So there still seems to be a challenge, I think, for you, for us in the community, and for the Commission to try to assure, if it's the case, the policy-makers and opinion-shapers from outside the antitrust bar as to why it is that current enforcement policy is getting it right.

So as we go through today, if there are ways that you can think of that we can better communicate that to those policy-makers and opinion-shapers, are there things that we could do to facilitate that along the lines of what former Assistant Attorney General Hew Pate has suggested to the Commission in terms of studies, I would appreciate hearing it.

In the meantime, just to break up the love-fest a little bit, Dr. Scheffman, you believe that the enforcement error rate is low, that the agencies are neither challenging mergers they should not be challenging, nor failing to challenge those that they should challenge, although I guess you profess slightly more confidence in the lack of Type 2 error. What is the basis for your confidence that the error rates are low?

MR. SCHEFFMAN: Well, my belief was, the last two years when I was there--and I don't think that was different than the previous 5 years or whatever--is that the number of mistakes was low, but I thought there were situations that I thought clearly were mistakes that went beyond my individual opinion, that the factual basis simply wasn't there

for bringing a case.

CHAIRPERSON GARZA: What do you attribute the mistakes to?

MR. SCHEFFMAN: I think the mistakes occur when, as I said, the typical fact--you don't have credible customer complaints. You're dealing with consumer products, and the supermarkets are not--you know, there are a lot of supermarkets, and they don't spend a lot of time thinking about this sort of thing. There are probably not reliable testifiers on the merits of a transaction, there isn't strong empirical evidence that there's a problem, there aren't hot documents, to which I would give less weight of course than the lawyers would, and, nonetheless, there's a case brought, based on a theory that two competitors are in some sense closest competitors without, in my view, a real solid factual basis for that.

When I was at the Commission I gave a number of speeches and talked about how I thought you could really get at that though, and I long said the simulation analyses based on scanner data is not a reliable way, but there are other ways, more basic

data that anyone can understand, and in some cases, I concluded there was clearly evidence that the companies were close competitors and that the competition would be reduced.

So I think it is when we get further away from customer complaints, solid economic evidence coming from natural experiments, you know, lack of hot documents, which I can understand fact-finders might consider relevant and important, where we're more making it up really, where it's more speculative, I think that's where the mistakes-- that's where, in my view, the mistakes are going to be. Again, I don't think the frequency is high. It's nothing like in the 1980s when we blocked lots of mergers that no one these days would even have looked at.

But I think the problem is that we haven't developed and we don't rely on evidence or analyses that really get us to the answer. In my written testimony I criticize economists for not developing analyses that are more relevant to the real issue, and that in the end will persuade lawyers and fact-finders that it's right.

CHAIRPERSON GARZA: Why does your confidence vary by error type, and should we care more about one type of error than the other?

MR. SCHEFFMAN: Well, I think there's pretty broad acceptance that mergers are likely to be efficient. There are a lot of good economic--been a lot of things written about that by Dennis Carlton and me and lots of other people, that mergers--and, as I've written long ago and other people have written, overwhelmingly, mergers aren't horizontal; they don't involve any antitrust implications, so what can these sorts of mergers possibly be about? They're attempts to achieve efficiencies, not in the sense of the Guidelines, but they're attempts to achieve a business objective, like any risky long-term investment in business, with the belief that it's going to lead to greater long-run profits, that is, be efficient in the general sense. We know that's true, because over 95 percent of the mergers are not anything any antitrust agency would look at.

So we have that presumption. That presumption doesn't--isn't a defense for any particular horizontal merger, but I think we also

know, and I think the Efficiencies Roundtable at the Commission made clear, I think we now know that horizontal mergers in particular are much more likely to be efficient than other mergers, in that we know--I don't think there's the slightest doubt for public companies in which they're projecting significant cost savings, fixed cost savings often, that those are undoubtedly achieved because they're targeted.

And all the stuff we've seen in M&A practice, the focus these days is on implementation, that is, you've got a good business deal; this makes sense. Now, are you actually going to do it? That's been the focus for the last five or 10 years, and companies--and you look at the FTC Roundtable--that is actually which companies are doing this. They're held accountable by the "Street." They're projecting, this is what we're going to achieve. And those are real efficiencies. We get into arguments in antitrust land about whether those, quote, "fixed cost efficiencies" should count or not, which I don't think is very productive and not really quite correct, but I don't think there's any doubt that standard horizontal mergers that predict, that have a

clear basis for achieving cost reductions have a high success rate of doing that.

What confounds the discussion is there's a lot of evidence also that mergers are not successful from a business point of view. That's true too. Most risky investments, major risky strategic actions by business are not financially successful. It's the 80/20 or 90/10 rule, that you get--a few of them are big hits, and some of them are big misses, and a lot of them are sort of mediocre, but the cost savings that are achieved are real. The fact that the business didn't achieve its overall business objectives of increasing profits as much as it would have thought is not the antitrust issue. I think it's very compelling evidence that, not all horizontal mergers, but horizontal mergers in which the companies have a clear basis for reducing costs, whether fixed costs or whatever, and have a plan in place to achieve those cost reductions, are going to do it, and that will lead to significant efficiencies.

CHAIRPERSON GARZA: One more question for you before I ask the other panelists to comment. In

your written testimony you seem to be careful to distinguish mergers, your comments on mergers involving industrial products and services from those that don't. Do you feel differently about the success of merger-enforcement policy today in non-industrial mergers, and if so, can you explain why?

MR. SCHEFFMAN: Well, I was using-- industrial is probably not the right term. But most mergers are business-to-business, or selling a major product or service to another major business, a large sophisticated buyer that's not a middleman like a supermarket. So someone that's actually using the product to produce something else, in which there are large buyers that are pretty sophisticated about buying. In those cases customer opinions are likely to be reliable and should be listened to.

When you get to situations where the customer base is diverse, where the customer base is comprised of middlemen or where there are other sorts of situations in which you really don't have reliable direct customer opinions, then we're more, in the end, really dealing with structural presumptions, and if we can get evidence from natural experiments or

other sorts of things, we can make reliable decisions.

But it's also very important--here's where the weakness in market definition--because I really do believe, with all due respect to my former colleagues in the agencies, I don't think that the outcome of *Staples/Office Depot* was beneficial to market definition analysis in the agencies. In recent years market definition has become something that they worry about seriously if and when they go to court. It's not that it's not paid attention, but the real focus is on developing an analysis of effects, and I think the real counterproductive thing in the '92 Guidelines was the focus on unilateral effects. I've written many times, it made the lawyers go back to 1970s antitrust analysis. These companies clearly compete with one another, so that's the reduction in competition.

Now, let's develop the argument as to why they're in some sense close competitors, so even though they have other competitors, competition will be reduced because of that merger. That's been a real problem that's an outgrowth of the '92

Guidelines I think, and a de-emphasis on market definition.

CHAIRPERSON GARZA: Mr. Baer, do you have any comments on any of the series of questions that we've just gone through?

MR. BAER: It's difficult, first of all, to make any kind of quantitative assessment of whether there's over- or under-enforcement. One hears criticism on both sides. The only comfort I can take, if you look at the cases that I've seen that have been litigated and lost by the enforcement agencies, there looks to have been in each of those cases, whether it be in the hospital merger area, *Arch Coal*, or *PeopleSoft*, to have been a credible basis for bringing the case, that the issue was joined in an appropriate way. There do not appear to be lots of silly cases being brought. And again, looking at those that are lost is one measure of assessing whether or not there's a problem there.

On under-enforcement, I think there are those who take the view, oil mergers and others, that there is, but the fact of the matter is, we have committed ourselves to an analytical process in the

merger guidelines.

The comment you made at the front end, in terms of explaining why it is we do less than we do to a Donald Trump or anyone else, it's hard. But the fact is, we have set some tough goals for ourselves in terms of trying to accumulate qualitative and quantitative evidence that gives us some confidence that we've appropriately defined a market, that we have a concentration problem, and that we have a competitive interaction that goes on today that will be substantially diminished and not replaced by something else.

And, you know, it's helpful I think that we have an articulated policy. It's helpful that we are transparent when we do not act as enforcers by articulating the reason so people can understand.

So it's very hard, always has been, to communicate to the outside world what it is that goes on inside the antitrust black box. But we need to try because it's important to have some sort of public acceptance and understanding of what we do and why we do it. And that's why I think our current system, where we are somewhat uniform in the

questions we attempt to ask and answer, helps.

CHAIRPERSON GARZA: Thank you.

Mr. Rill, do you have any comments?

MR. RILL: Very briefly. I was intrigued by the criticisms, the citations to criticism, particularly the *Wall Street Journal* editorial which laid what are perceived to be the evil of the *Oracle/PeopleSoft* case on the back of Tom Barnett, who wasn't even at the Justice Department at the time the case was brought, and I at the time was lead counsel for *Oracle* and have some knowledge of it.

At any rate, I think the process is, after all, evolutionary. We've been at it for a while, and as Bill said, we're not going to be looking at the silly cases that might have been brought in the '70s. I think the learning process is evolving, and I think the weight given to customer testimony is important, but then it has to be informed customer testimony, and I think there's a lesson to be learned that I think the agencies are addressing, again, looking at cases that the agency has lost, both from *Oracle* and I think more particularly from *Arch Coal*.

We're dealing with increasingly complex

markets, and I think there's a learning process there as well to deal, for example, in markets, software industries. I think again a lesson to be learned perhaps from, I would have to say, the somewhat uncertain path that the staff followed in the *Oracle* case, to recent clearance by the Department of Justice of mergers, such as *ScanSoft/Nuance* in the software area, where a quick snapshot of the industry and the number of competitors in the industry might have led to a different conclusion without that learning process.

I think that one needs to take a look at the efficiencies conclusion in the *Heinz* case, the *Heinz* baby food case, in which Commissioner Anthony was persuaded that there were overarching efficiencies there. But the Commission brought the case, and how much it turned on the peculiarity of Section 13 of the FTC Act is another matter. But then compare that with the recent Justice Department statement in the telecom mergers, the *SBC/AT&T and Verizon/MCI* cases, where the department went out of its way to say that there were overwhelming efficiencies, perhaps even dynamic efficiencies, that were persuasive, and

conditioned other factors in those cases. One sees how evolutionary the process is.

I think the error rate is low. I think one needs to look at the erosion of the concentration--not elimination--but erosion of the concentration presumption by taking a look at the study cited in our papers, the horizontal merger investigation data, which really reveals where, as of at least 2003, the agency was in reviewing concentration. So I think that piece speaks of a low, relatively low error rate even better than perhaps some of the citations that are always given to look at all these mergers that are filed, and look how many we bring. I don't think that tells you much of anything, because some of those mergers are possibly real-estate mergers and mergers where there's no competitive overlap.

But I think this document out of the FTC, the horizontal merger investigation document, is very telling in the direction of the quality of enforcement.

CHAIRPERSON GARZA: Thank you.

Mr. Willig, do you have any comments?

MR. WILLIG: Yes, thank you.

I don't see any major error rate, and I don't see any particular bias in that error rate, Type 1 as opposed to Type 2. My foundation for that view is not, unfortunately, an academic style study *ex post*. We've been talking about doing such studies for how many years? And it turns out to be very difficult, of course, not because of the methodology but because of the availability of the necessary information.

Rather, my view is based on my own personal exposure, a fairly random basis to a sample of cases where I observe what the agencies do either firsthand or through other economists, and I don't see systematic errors. I see a very well intended path of analysis by the agency. I see errors that do occur. I see largely four reasons of human or organizational error. Some part of the staff goes off on a wrong track, and it turns out to be persuasive within the agency, or a senior executive of the agency, for whatever reason--I wouldn't call it political, but kind of personally political--gets off on the wrong foot about a circumstance for whatever reason, and is not able to be dislodged by

others around that person in the organization. So, there are common kinds of failures at the human and organizational level.

Which brings us to the question of how to protect against those kinds of human or occasional organizational failures. What are the checks and the balances that should be helping to keep the organizations on track? Again, I think by and large we're doing a good job. I think one of the major needed checks and balances is transparency, and that goes to the increasingly forthcoming press releases by the agencies, and I very much applaud that as a trend, to keep Donald Trump quiet or better on track, but also as a way to let the Agency know that they're going to be made public in their course of analysis, and that's an excellent source of greater care I think.

But the other check and balance about which I'm concerned is the absence of transparency when it comes to the more searching kinds of economic analyses that very much characterize later-stage merger analysis. Today at the agencies, when there's a long case, the full second request, a close call, a

high-profile case, lots of economic analysis gets done within the agencies, as well it should, and I'm excited to see as an economist how influential those analyses tend to be, even among lawyers and those who are otherwise somewhat resistant to economics.

But I think economic analyses have become increasingly influential. My concern is that those influential economic analyses have not been able to be exposed through review to examination by the parties, by the parties' own economists and lawyers as well. And so if errors do creep in--and occasionally they will--both in terms of the data themselves and their interpretation, but also in terms of methodological choices that have to be made, inevitably, in the midst of economic analysis, if those analyses are not being exposed, and the dialogue is cut off, then the errors become somewhat subject to going off into a spiral of wrongheaded conclusions, which don't get corrected as they might otherwise in a more transparent framework--

So the question is, why is economics particularly resistant to transparency when the agencies are properly dedicated to being transparent

with other forms of their own analyses? I think the dedication is there, but it hasn't been effective in the domain of economics. I think the reason is the confidentiality of the data that underlie the economic analysis. Economic analyses are always laden with the needs for data, and when the data extend to third-party production, then there are real hurdles in terms of confidentiality that stand in the way of transparency. I wonder if this Commission, if the community can do better than I can do, in terms of thinking about possible remedies to somewhat mitigate that as an issue.

I think it does serve as a major problem for the reliability of agency conclusion-drawing in today's age.

CHAIRPERSON GARZA: Thank you very much. Thank you, gentlemen.

I will now turn to Commissioner Litvack.

COMMISSIONER LITVACK: Thank you, Chair.

Thank each of you. Your statements and your answers to the questions today are really helpful and very profound.

Nonetheless, I must tell you, I--and I think

I'm alone on this panel--am sort of disturbed, because probably--not probably--certainly, less than everyone else here, I have, over the last decade, been far less a member of the antitrust bar and antitrust practice than any of you. And so I take a step back and I say, "Great, everyone says merger policy is working terrifically." We all pat ourselves on the back, and call for the next panel.

[Laughter.]

COMMISSIONER LITVACK: The only thing anyone seems disturbed by--and that's mainly--I was going to say mainly Mr. Baer and Mr. Rill, who are the practicing lawyers like myself--it is the second-request process. So we can skip the next panel, go right to second request and try to figure out what to do. But before we go quite that fast, I am troubled by Don Imus. I am troubled by Donald Trump, in the sense that if you were to walk the street and ask the average person, "Do you think that there are too many mergers, that companies are too big in the United States, that there's too much concentration?" I will wager that the answer will overwhelmingly be yes.

Now, that doesn't mean that that's right,

but it does suggest that there is a disconnect somehow between what the antitrust practitioners think and what the world thinks, the world being defined by me as the U.S. populace here.

If that's so--and I really believe it is--is this just a public relations problem, or is there the possibility that there's a disconnect, that the antitrust bar is in fact not being responsive to what the public thinks or wants or should want?

You know, Mr. Baer said we have a rigorous test, and it's hard to explain to people in many cases why we do what we do. I put to you the question, well, if that's so, is it maybe that the test isn't right, and maybe when you can't explain something, maybe you've got a problem?

Since I know I have four people disagreeing with me, let me start with Mr. Willig.

MR. WILLIG: Thank you so much. I'm almost hopping out of my chair for the opportunity to respond.

COMMISSIONER LITVACK: I sensed that.

[Laughter.]

MR. WILLIG: I'm in a very privileged

position at the university. One of my colleagues is Professor Kahneman, who was trained as a psychologist, but just won the Nobel Prize in economics a few years ago for his pertinent insights into psychology.

One of his primary lessons that he teaches is the importance of framing, that a clever survey-giver can extraordinarily influence the answers by the way the question is phrased, and even by the body language of the questioner. And I immediately, in listening to you, went to the teachings of Professor Kahneman and asked myself--well, I'm imagining on the street I asked the random passerby, "How do you feel about all those big mergers?" And of course the passerby will say, "Oh, it's terrible. Things are going to hell around here. Things are too concentrated."

And then the next random person coming down the street, I'm going to ask a different question. I'm going to say, "How do you feel about the Government interfering with business?" I hear one story, another story. You know, the government has the right and often says no if they want to just

combine and make a bigger store. And I think that same passerby, who a minute ago was complaining about all the mergers, in answer to my second question is going to say, "Oh, yeah, the government's all over the place. It's just terrible. Taxes are bad, and you know, antitrust is terrible, and the government should just sort of stay in Washington and get out of our faces."

I'm not sure the kinds of expressions we hear about mergers are really sufficiently reliable for us to take very much into account in the formulation of policy. With that said, we can certainly be clearer about the rationale behind the antitrust action, and we should be, and we should teach more in school--I love to lecture in high school economics classes about antitrust. We could certainly be more forthcoming and a little bit braver about expressing the real reasons behind our conclusions, because they are well founded and they are responsible, and sometimes 10 years later they may look silly, but nevertheless, if we have the courage of our convictions, I think we would do a better job with PR.

COMMISSIONER LITVACK: Thank you.

Professor Scheffman?

MR. SCHEFFMAN: Yes, thank you, Commissioner.

Well, we have a longstanding, from the beginning of the country, strain of populism in this country that's about anti-big business, which is interesting, which if you look at other countries--some which I've lived in actually--they don't have quite the same populism. I don't see the problem when I live within the Beltway. Maybe we're going to have a problem, but it's not a political issue. The Clinton administration, Bill Baer presided over the--as one of the Commissioners said, putting the Standard Oil trust back together, you know, and it wasn't--

MR. BAER: Thank you for reminding people of that, David.

[Laughter.]

MR. SCHEFFMAN: There are harsh critics on the Hill, Senator Wyden the leading critic, of what's happened in our oil industry, and that's come back because of Katrina and everything, and there's a full

vetting. As you would expect, the FTC is doing a major study. I think if it's a political issue, antitrust and merger enforcement is bipartisan; it's not that there aren't critics on a specific case, but no one on either party is running on that merger policy is fundamentally wrong, and that's what--I guarantee I was there, as you were, there as I recall, you know, right before the early '80s and maybe even in the early '80s. And I was there. I always knew exactly what the political debate was about.

I think it's over. I'm not saying we have to worry that it would come back. We have to be clearer and explain why what we're doing, and the great expense of all the investigation of the oil industry now is going to be beneficial just like the FTC's investigation of the outcome of *Ashland/Marathon*, and of the Midwest Gas thing and everything. There have been retrospectives done. There are more being done. So I think we need to be vigilant, for those of who believe that--and I think that, in the general antitrust community, we got it approximately right--to be vigilant that this doesn't

turn into a political issue, but I just don't see it. Maybe Imus and Donald Trump picking it up means it's burgeoning, but I haven't seen that listed on what's going to be the lead--in the Iowa caucuses--that's going to be the leading position to have.

COMMISSIONER LITVACK: I don't think so.

My time is up. Madam Chairman, could I give--would you give Mr. Rill and Mr. Baer an opportunity to--

CHAIRPERSON GARZA: Yes.

MR. RILL: I can be very quick. As Bobby will be the first to tell you, I'm not a trained economist, but I am something of an historian. And I go back to some of your experiences, Sandy, and even before your experiences with the so-called "concentration hearings" of Phil Hart, and legislation to break up, among other things, the oil industry, the auto industry, which, to your credit, you didn't file on. It seems to me that we've always had the bigness is badness syndrome in the United States.

It's interesting that the Chairman brought two sources of complaint to our attention. One is

the Wall Street Journal and Jack Kemp, which she lumped into one category, and Donald Trump and Imus which she lumped into another category.

It seems to me that the extreme left and what I call the extreme right--probably got it about right. With that superficial comment, I'll let Bill chime in.

MR. BAER: I think it's the right question. It's a fair question. And my answer is first of all that being the antitrust cop on the beat creates probably false expectations of what antitrust enforcement can and should do, and the public perception or misperception that aggressive competition is in fact anticompetitive behavior is a problem. I've written in the past about the Wal-Mart phenomenon. People want to use the antitrust laws to prevent Wal-Mart from coming into a local community. That is a social policy issue. It's a question of whether you want to get the benefit and endure the cost. So the problem really does come down for me to one of communication, and there is a tremendous obligation I think on enforcers to talk about it, to talk about why one can't find evidence of collusion

despite the fact that oil prices are going up, and the same, you know, economic conditions were affecting rises and falls of prices 10 years ago, before ExxonMobil. It is a challenge and it's an important challenge, and I think antitrust needs to pay considerable attention to it. But at the end of the day I think it is more a communication problem than a problem that requires a change in direction.

COMMISSIONER LITVACK: Thank you.

Thank you.

CHAIRPERSON GARZA: Thank you.

Commissioner Carlton.

COMMISSIONER CARLTON: I want to thank all the panelists for their fine statements, and also for their public service, which I think did a great deal in improving sort of merger policy. I had really two questions. Let me first start with a question directed at the economists.

I think it's correct to say that the Merger Guidelines have had an important effect on court decisions and how courts interpret markets, and they've looked to them for guidance. They've looked to the Merger Guidelines for guidance not just in

merger cases though. They've looked to them in terms of market definition in Section 2 cases. So I would like to ask each of you, in a Section 2 case, where you have a requirement, say, as to whether there is market power, not whether there's some bad act that worsens market power, but rather whether there is market power to begin with, do you see the Merger Guidelines' market definition as being appropriate to modify in some way or to address that question? And if so, how? Now, I know each of you could probably give a lecture on that question. So I only have 5 minutes and there's one other question; let me just ask you to keep your answers short.

So, Bobby, you want to go first?

MR. WILLIG: Sure, thanks. I think there's a lot to learn from the hypothetical monopolist test of the Merger Guidelines for other forms of market definition in other kinds of analytic settings, including Section 2. However, I think one cannot take the precise market definition routine from the Merger Guidelines and transplant it unthinkingly into a Section 2 context.

For example, to me the biggest confusion

when it comes to market definition in Section 2 is our failure often to ask ourselves the question, are we looking at the market pre- or post- the complained-of practice, the practice that we fear may in fact have caused an undue increase in market power? And how one proceeds to do market definition depends totally on whether one thinks one's looking at the market before or after the impact of the challenged practice. If we're looking at the market after the challenged practice has already allegedly had its anticompetitive effect, then the cellophane fallacy is quite real, and it's incorrect to move from there to a further increase in prices to ask what might be the impact on profits or on the shape of the market. One has to roll the situation back as a conceptual frame to the situation before the practice is actually put into effect. Sometimes the market is actually before the time that the challenged practice has had its feared effect.

And so in either of those cases it's still useful to talk about the hypothetical monopolist. It's still useful to set the definition of the market and to look at concentration and competitive

significance within the relevant market, and there the purpose is not to see whether the coming together of two parties significantly raises market power, but whether the alleged demolition of the competitive capability of one of the competitors makes a significant difference to the overall shape of competition in the relevant market.

COMMISSIONER CARLTON: Okay, thanks.

Dave, could you just comment briefly, and just as Bobby said--wait, just to clarify my question. Pre-bad act, the issue is--the confusion I've seen is specifying pre-bad act what the competitive price would be in trying to adapt the Merger Guidelines. Maybe you could just, just for a short answer.

MR. SCHEFFMAN: Well, the economics underlying the Guidelines' market definition are based on the presumption, rebuttable presumption, that significant increases in concentration in a market properly--I think most economists would argue that the hypothetical monopolist is the proper paradigm, in that case in the final market, you know, presents--causes a prudential basis for concern. Now

in a monopolization case we're talking about conduct of an individual competitor in the competitive environment. The framework is not necessarily the same. The predicate is not the same. The issue is the conduct, and of course, as a matter of law you get into issues like you've got 70 or 80 percent and if you did anything bad, it must be anticompetitive. That's where things go wrong and where you have to be more careful in defining the market realistically, because if it's 70 percent and whatever you did was anticompetitive because of that, then that's not good policy and it also leads to differences in how you might define the market. It would depend on the situation.

COMMISSIONER CARLTON: Thanks.

Let me just ask this question of the attorneys. In defining markets, what I've seen is, especially when there's a reliance on customer documents, people in a sense ask the question, if price goes up five percent based on these customer documents, what other products are they going to consume, or could they consume as substitutes? And then those sort of go in the denominator and you can

calculate a rough market share. Does that square with your sense of in practice how people initially try to use customer documents to define markets?

MR. RILL: I think at one time it did. I think there's a good bit of learning that's evolved from some of the recent cases, that I think there's a richer and deeper examination of empirical evidence in the market to define the relevant market, not just merely where you would switch, and even sometimes that question was asked wrong as in the *Country Lake Foods* case. But you should look at actual natural experiments of switching that have taken place in the market, look at companies' strategic planning documents in the market, and look at the companies' meeting competition documents to find out the empirical evidence of what's actually happened in the marketplace to define the market.

And there, I think, Dennis, it's not only important as a clearance for the concentration screen analysis, but also to identify the firms that are in the market, to see who the players are and who they are likely to be, to look into those kinds of actual empirical data that will provide us with a much

richer and deeper understanding of the market than simply asking somebody, "Well, if prices go up, pick a number, five percent, 10 percent, what would you do?" One would even have to look sometimes at the credibility of that kind of testimony as well as the informed nature of it.

MR. BAER: I basically agree with that. I think to the extent that there had been a tendency to look to customer evidence as the primary basis for defining markets, the outcome of the *Oracle* case has caused the enforcers to take a hard look at whether they are asking the right questions and whether they need to develop a analytical presentation that is more demanding of what they're looking for from the customers, and takes into account the sorts of evidence that Jim described.

COMMISSIONER CARLTON: Thank you.

CHAIRPERSON GARZA: Thank you.

Commissioner Valentine?

COMMISSIONER VALENTINE: Okay. Good morning all, and we'll skip the niceties to make best use of our five minutes.

I'm happy to hear that you all think things

are going basically right with the Merger Guidelines, because I agree. But I wanted to ask one question, which is one thought we have heard from other panels: there have been a lot of improvements and advances in thinking about innovation and innovation markets since the '92 Guidelines, but that, perhaps, they should be amended to reflect this improved thinking in the innovation area, and whether that be, you know, saying something more than market definition is quality adjusted price, or whether unilateral effects should talk more explicitly about when new products are introduced, to what extent they take sales away from rivals, maybe even that coordinated effects are rare or difficult, innovation, or R&D markets, maybe something with the efficiencies to talk more fully about R&D efficiencies, innovation efficiencies.

Can any of you think of anything that we actually ought to do there? I'll just start with Bobby and go right.

MR. WILLIG: Sure, thank you. My view is that in the area of innovation, which is obviously an incredibly important part of economic activity, an important part of competition, like in other segments

of the economy and other forms of competitive activity, the same kinds of concerns that we see that should be driving the merger policy are very important there as well.

I think that the Guidelines set a broad enough framework so that those same economic concepts and the same templates for analysis work just fine when it comes to innovative activity as they do when it comes to garden variety pricing activity or quantity setting or the setting of quality attributes of product. The details are going to differ. I think we have seen the Guidelines applied across those different areas of economic activity well and accurately with attention appropriately paid to the different details of those areas of competitive activity. It still might help to have explications on a case-by-case basis from the agencies or from the parties to actually explain to those who need to take those steps later, and helps them from having to reinvent the wheel, how the Guidelines can be effectively applied to differing areas of activity.

COMMISSIONER VALENTINE: Got you.

Dave?

MR. SCHEFFMAN: I think it's much more complicated, because it has to be done through not just economic analysis. In mergers, because *of Baby Food*, we have a very strong presumption that a three-to-two is likely going to be a problem, and I think that's sort of broad-base acceptance, including by me, that's where the right line is for product market, other than I think the issue in *Baby Food* is that I think it was 2.1 and shrinking to two and there were efficiencies. So there are issues about the implementation, both market definition and how many competitors you actually count.

Fundamentally, with innovation that clearly is not where the line should be. We don't know where the line should be, because there's no presumption, there's no economic presumption, unlike there is in actual competition or products and services that reductions in the number of competitors will reduce innovation competition, even going two-to-one. I'm not comfortable as a general matter that two-to-one was, you know, I would need a lot of convincing that two-to-one, but three-to-two is not a hard case to become convinced based on the facts in the situation

that a merger might not be problematic.

So I think that, given how we actually implement merger policy and the attempts in the past to look at innovation markets and count the number of competitors in that, I think it was understandable why that was done. It was totally counterproductive. As I said in my written testimony, I agree with Chairman Muris's statement entirely in the *Genzyme/Novazyme* thing. Now, wait a minute; that presumption's not right, and you have to look at it on the merits of the situation and--

COMMISSIONER VALENTINE: Okay. I guess the question is, should we change the Guidelines at all to reflect this?

MR. SCHEFFMAN: Well, I don't think the Guidelines--the problem is, there are a lot of areas where the Guidelines don't really provide any guidance, and I think that's one.

COMMISSIONER VALENTINE: So you'd just leave them as they are.

MR. SCHEFFMAN: When you're talking about innovation competition as opposed to, say, imminent pipeline-product competition, I don't think the

Guidelines provide guidance. I think in the 1990s that was what the Commission was trying to do, and I don't think that was successful.

MR. RILL: I think the problem is not the Guidelines, but the Guidelines compared to what.

COMMISSIONER VALENTINE: Right.

MR. RILL: And what other analysis there might be that would lead to better results. I think that the Guidelines track of analysis isn't wrong. I think it's the application of any kind of form of Guidelines to something called an innovation market, which is something of an oxymoron in itself, that creates the problem. I don't know how to judge in the abstract the next-best-substitute issues and R&D capacity in a pure innovation context where there's no product in the market at all, or who the most likely entrant, if you will, into an innovation market would be, or what the capacities for R&D were. I don't think that's the fault of the Guidelines. I think it's the fault of needing greater learning in the area of innovation before we plunge into it.

I think there's something, some reason why I can't think of any particular case that's been

brought by the agencies on a pure innovation market theory where there hasn't at least been a product in the market or right about to an issue forced into the market with FDA approval three minutes away or something close to it. But I would yield the pharmaceutical industry comments to my colleague on my left.

MR. BAER: And I will basically defer back to Commissioner Valentine. I think I basically agree with Mr. Rill's thoughts on that.

COMMISSIONER VALENTINE: Thanks.

You wanted to say something more?

MR. WILLIG: I'll jump right in with one quick reaction. I think part of the confusion is that innovation is not always necessarily a separate relevant market. If the hoped-for innovations, if successful, will compete with existing products, those existing products have to be put into the relevant market. This is not a failure of our understanding of innovation. It's too shallow an application of the Guidelines.

COMMISSIONER VALENTINE: That's a fair answer to what I was asking for. If I could just

clarify the record on *Baby Food*. Efficiencies were fully accepted by the court in that case. The decision was written by a Supreme Court clerk, whom Areeda referred to as one of his best students. There were two Republican judges on the D.C. Circuit who joined in that opinion, and I will take their views any day over the views of either Don Imus, Mr. Trump, or the *Wall Street Journal*, who had not read the record nearly as well as the Supreme Court clerk or judge, who had probably read every page of the record and more than some of the opposing counsel in the case had.

MR. RILL: My silence doesn't necessarily connote agreement with Commissioner Valentine on the *Baby Food* case.

CHAIRPERSON GARZA: Commissioner Kempf?

COMMISSIONER KEMPF: Thank you.

Professor Willig, you mentioned the desire in some quarters to jettison market definition as a part of the equation, and you referred to that as new. I would refer to that as old. Let me give some historical context to it. Market definition, back in the '60s and '70s was always a trap for the

defendants. It was a way the government could secure reversal of a case with one blow on the grounds that either the product market, the line of commerce, or the section of the country, the geographic market, was improperly defined. That reached its height maybe in the *Pabst* case, where Justice Black said market definition is an entirely subsidiary question to the key question of whether it is adverse to competition.

It may strike some as being a little bit circular, or perhaps more than a little bit, but that was what he said. He said this is a secondary—"entirely subsidiary", I guess, are the exact words he used.

If you were trying cases back in those days, you were always worried about market definition, and so some of us got in the practice of, when the judge would say, "What is the correct market definition?" we would say, "It doesn't make any difference." And that way you could avoid losing on a reversal on market definition grounds, and would usually try to persuade the judge to say that, however you look at the market, and you try submitting your findings, if

the market is this, it's not a problem, or if it's that, it's not a problem. The reason for that was often that the spread-ask--the bid-ask was so wide. Let me give you three examples.

In *General Dynamics* if you defined it as the energy market, it was less than two percent, and on a presumption thing there were no competitive effects at all. If you defined it as coal, it was like 40 percent, and you had a big problem.

In Greyhound's acquisition of Trailways, if you defined it as intercity travel, it was like eight percent; if you defined it as bus travel it was 98 percent. So there, if you were choosing the market and that was the be-all or end-all, it was too easy for some on the other side to say, "Well, I disagree with the market," and flip the result. So you would always say it depends on the factors. And those don't change. Whether you call it energy or coal, whether you call it intercity travel or bus travel. So let's get beyond that and do it that way, and then, judge, you can say whichever way you define it, it makes no difference.

And then another one was *Staples/Office*

Depot, where again, you could view it--if you viewed it as superstores, it was a merger to duopoly or a merger to monopoly in many markets, whereas if you viewed it as everybody who sold office supplies, the market shares were trivial. And the desire was always to try to avoid falling into the trick bag of having a turn on nomenclature rather than substance. So I think that's sort of maybe some historical stuff on that.

Let me ask a question a couple of you have touched on, and Chairman Garza touched on, and that's the study question. Why not take a backwards look at merger enforcement to answer whether Don Imus or the *Wall Street Journal* is right? I know the FTC did one where they did, I think, six mergers. I was in a couple of those, and I couldn't even recognize the cases from the study.

[Laughter.]

COMMISSIONER KEMPF: But sometimes, you know, they have consequences, and let me give you one example. *Staples/Office Depot*, the market definition by the government, which they advocated very strenuously, was the superstore one. In the wake of

that, the client said, "Well, what should we do?" And I said, "You know, you want to get efficiencies through growth size, and they've set out a roadmap for you to do that now. You can take all the ones that we said were highly competitive and they said were completely noncompetitive, and just buy all them up." And I said, "And do it fast, because they're going to be gun shy of challenging them in something that is the opposite of what they just said."

So the mail-order competitors, for example, disappeared within a couple months, huge companies were all immediately gobbled up by them. And they then went systematically through and just achieved volume by making acquisitions of all the people they said were not really competitive. But you could undertake a study--and someone once told me that in the *Vons* case, the acquired company, instead of being acquired by another small competitor, was acquired by one of the super stores. Wouldn't that make sense to do? That's one thing that former Assistant AG Pate has suggested. We decided as a Commission not to undertake that as part of our assignment, but would that be a sensible recommendation as a follow-on

activity this Commission could endorse someone to undertake? Reactions from everybody.

MR. WILLIG: It always sounds great to me. I love the idea of careful studies, especially done by those without, necessarily, any axes to grind, or economists, to be sure, and every time in my 20- or 30-year experience in this particular domain, that another wise body articulated the need for such, and you wouldn't be the first to be in that position, not that you shouldn't--

But if you can accompany it with a practical roadmap for how the data can be assembled and acquired to do the study, that would make that conclusion much more powerful. I've been buffeted all my life as an antitruster by, oh, the needs of confidentiality--which I respect--but I'm always frustrated to hear that. And if you folks could somehow put your legal minds together and figure out how to open up a crack in the wall of confidentiality to allow such studies, as well as greater transparency, I think you would have obtained a marvelous outcome for your efforts.

COMMISSIONER KEMPF: David?

MR. SCHEFFMAN: Commissioner, I guess you never read, respectfully, Tim Muris's speeches. I mean, we did do that. He did initiate efforts, and the efforts had been done before we came back. We had more time because we weren't in a merger wave. But we have *Ashland/Marathon* and the studies you were talking about.

I think it's--and we despaired of finding outside academics to come in; "We'll give you confidential information; why don't you do a study?" I always thought it was a lot easier than that to develop credible evidence which is in the markets where there are--in industrial markets where there are, you know, not numerous, and they're large and sophisticated customers, why not do something?

I think a big weakness or a big--in the divestiture study, there was a tremendous opportunity there to go and ask the customers, "Wait a minute; what happened in the market? We could do that independent of divestiture." You could do that, and it would not be data we would stick in econometrics, but I think, if you had knowledgeable customers, you could absolutely do that. The DOJ can't do it I

don't think. FTC could do that. And that's something I thought we should do, do focused interviews, surveys of customers and get other information in industries in which there wasn't a challenge, and say, "Well, what actually happened?"

MR. RILL: The key is whether or not they're reliable studies it seems to me. I don't know that anyone that I've heard said that studies are a bad thing, but I worry about something that Commissioner Carlton pointed to in the merger hearings that were conducted by the FTC and the DOJ, in the old story about the person that was looking for the event under the light post, not because that was where the event occurred, but because that might be where the most light was. Some of us are old enough to go back to a Scherer-Ravenscraft study of mergers the was conducted back in I guess the late '60s or early '70s, which showed that mergers were not efficient, they were not efficient. Of course, the database was all conglomerate mergers, because there weren't any horizontal mergers in those days, and that's something wrong with that study.

I think, yes, if the data are reliable, if

one can account for extrinsic factors looking at the retrospective context of a merger, that would be a very good thing, but if we can find a--to pick up on Bobby's point way that we can be certain or reasonably certain that we would really shed light and not heat on those kinds of studies, then I think we would be all for it.

The way to do that and the way to regress out the extrinsic factors to be sure that we're isolating the effect of a merger in a retrospective analysis, I leave to people smarter than I.

MR. BAER: I'll be brief. I think such studies are a good idea, and more ought to be done. And I'm leaving aside for the moment how much fun you and I would have over a beer reviewing the *Office Depot/Staples* study.

[Laughter.]

MR. BAER: If you look in fact at what happened to hospital merger enforcement over the last 10 or 15 years, this clearly was a case where you could make an argument there was over enforcement, because the agencies were systematically losing these challenges to hospital consolidation. And one of the

things that the Muris FTC did was go back in and take a look at some of these consummated mergers, again, to try to understand whether there had been over-enforcement. They ended up bringing at least one case, the *Evanston Hospital* case, where the administrative law judge has just issued a decision, finding--it will be reviewed on appeal--finding that there were systematic price increases attributable to the combination.

So I think there is value to going in, and part of it is being able to explain why you did what you did if you can point to post-consummation evidence that in fact there was or was not a particular price effect in a market.

CHAIRPERSON GARZA: Thank you.

Commissioner Jacobson.

COMMISSIONER JACOBSON: Thank you. Taking as my point of reference the Art Buchwald column that is appended to Justice Douglas's concurrence in the *Pabst* opinion, to which I commend everyone here, I want to address this largely from the angle that Sandy took, which is that there's no doubt that the mistaken allowance of an anticompetitive merger can

be harmful. There are corrective measures structurally for over-enforcement by agencies, those being the ability to go to a district court or to a court of appeals for correction of mistaken enforcement decision.

What methods should there be, and do the methods that exist today provide an adequate basis for under-enforcement, for the mistaken agency decision that occurs from time to time to allow an anticompetitive merger? And we've been going to my left, to my right, so let's reverse it and start with Bill.

MR. BAER: Thank you. I think some of your question really goes back to the last--my answer goes back to the last answer I just gave. You do need, in order to be able to make some judgments about whether you're properly enforcing, not under-enforcing, is to have some analysis periodically of decisions you took, in the European parlance, not to enforce. And I think it would be very valuable to have both agencies devoting some resources to attempting to do it. Some of it would have to be non-confidential, subpoenaed information. You might have to sort of

whitewash some of the results you would publish, but I think the learning would very much inform agency decisions with regard to under-enforcement.

COMMISSIONER JACOBSON: But other than studying, *post hoc*, the events, is there any process that we should have to address that issue when it surfaces?

MR. BAER: No, other than--I mentioned earlier, I think, transparency when you do an investigation, as occurs regularly in the European Union, to have some sort of statement as to what factors led you not to enforce. I don't know that you necessarily need to or should do it in all cases, but as to major matters, having some--the cruise ship thing is a wonderful example. There was a controversial decision not to enforce, but at least they laid out for all of us some sense of which factors they considered and how they got to where they got. That's very helpful.

COMMISSIONER JACOBSON: Jim?

MR. RILL: I think, Commissioner, that Bill is about on the right track. It seems to me that transparency in the decision-making process and

whatever can be done with the retrospective reviews is probably the limit of practical application. I think if the implication of the question is, do we think that one should go back and undo a merger that was reviewed, but then possibly one thinks that the decision might be wrong, I think we're opening up a terrible Pandora's box of throwing a lot of friction into the system and reaching equally uncertain results even if that's attempted.

COMMISSIONER JACOBSON: I am not suggesting that. I am going to suggest that limiting the multiple enforcement mechanisms that we have would be the opposite way to address that problem, and would be for that reason inadvisable, but I'm not suggesting--

MR. RILL: I agree there, there are serious problems of certainty, and I think even of, not necessarily always of result, but certainly some curious settlements that have been reached under our multiple enforcement system. I don't mean multiple as between DOJ and FTC, and I'm not going to get into the clearance issue, but quite frankly, if one wants to look at some of the state settlements in

independent actions, the chocolate case in Pennsylvania, the apparel case in North Carolina, one comes up with some really head-scratching issues with respect to whether or not the multiple enforcement produced any consumer welfare effect or was it really a home market, home court advantage to the state in those cases?

COMMISSIONER JACOBSON: That's a fair point.

David?

MR. SCHEFFMAN: Well, as I say, I think retrospectives are very important. If it was at the FTC we certainly would be looking at cruises, because it still remains to be somewhat controversial. The Commission did look at *Baby Food* some. I guess that has an issue report. Luke Froeb made some speeches about what they had found, because we have to learn from--in antitrust law things move forward, new theories, *et cetera*, and the learning really comes from what the courts do. Unfortunately, that affects the overall agency prosecutorial decisions, even though overwhelmingly everyone knows most deals aren't going to go to court. What the courts do really does significantly impact what the agencies do

across the whole range of transactions. But I think more retrospectives, that you need resources for that.

COMMISSIONER JACOBSON: Professor Willig?

MR. WILLIG: Yes. And might I say what a pleasure it is to sit next to Mr. Scheffman today.

I had forgotten to compliment you, David, publicly on the treatment that you gave personally, and your colleagues, to the Cruise Lines decision. That was remarkably forthcoming and enormously illuminating to the community, to my students. It's on every reading list in industrial organization, or it should be, and I don't know how you managed to overcome the usual barriers to divulgence of what's often viewed as proprietary or confidential information, but somehow you and your colleagues did so.

Likewise, on the other side of the enforcement divide, *Staples/Office Depot* has a great record of writings by Commission staffers and speeches on the subject of how those conclusions were reached, I guess driven by litigation, although I think there were some working papers from the

Commission prior to litigation exposing some of the issues.

But can you folks help when it comes to the policy platform that you have in terms of somehow opening up the window to what's otherwise viewed as confidential information? Is it actually the stricture of the law that clearly stops the divulgence of more information, or is it perhaps an overreaction to what the law actually requires? Could we be somewhat more aggressive as a practice at the agencies in allowing some cleansed version of information that's gathered under confidentiality out for the purposes of greater transparency and perhaps building a better record for the public to appreciate?

CHAIRPERSON GARZA: Commissioner Yarowsky?

VICE CHAIRMAN YAROWSKY: I too want to thank everyone for appearing. I think this panel represents why we are in a certain stable golden age of intellectual clarity about antitrust. But, you know, there are certain cycles in that, certain stable periods where there's a sense you know the dynamic and the principles to apply. I think we're

in an agency-centric age, and you all have contributed to that in terms of developing the learning. At other times Congress drove the learning, and other times the courts drove the learning. But I think we're at a very advanced stage economically. Politically, I think the panel has made the point that all of that churn is gone for the most part, blessedly.

But here's my question. I really want to look at--if I'm somewhat correct on this--when I say agency-centric, that's kind of the driving force. That's where the outreach is now to the global community. That's where the learning in these guidelines are. I want to think about the courts for a minute, and then obviously just let's say the business community.

I spent a year and a half in judicial selection in the White House. One thing I learned was, and this is no criticism, most of the candidates for the federal bench really don't have a background in antitrust. Now, they'll get it. As you know, we're talking about generalized courts of jurisdiction, Article III. These aren't specialized

Article I courts. Same with intellectual property or any other subject. But what I had to think about a lot, just because it was of personal interest to me, was the fact that at that point in time, the Guidelines development was very much in effect and at high tide, and I didn't see a lot of awareness of what was in those Guidelines. I knew there would be a lot of learning going on. You can't make special assignments to certain judges who might be of antitrust backgrounds. They're just going to basically draw it as a lottery system.

For that reason, and I have no fears about that it's not going to work out, but for that reason, I would love to have your judgment about whether judges who really do, day-in and day-out, regardless of the subject matter jurisdiction, deal with presumptions, kind of structural presumptions, rebuttals of assumptions, and then work with facts all the time. If we stand back and look at the height and state of the Guidelines, do you think most federal judges have--and I think you said it, Mr. Willig--a practical roadmap when they're faced with a complicated merger case so that they will be at that

point of being able to apply the learning of the Guidelines just as you all have done and continue to do? That's the first question.

The second question goes to another part of the community outside the agency--and we've touched on it--and that's the transparency issue, and that is, should we give some feedback for those transactions that are let through routinely? There were efforts, as Mr. Rill remembers, in Congress in the '80s to require that, not in any onerous way. It was a good faith thought. But I think there was some real hesitation from the agencies at that point. It may have been the confidentiality issue, but there may have been other reasons about, was this a wise idea for precedent-setting purposes?

So if it's possible to try to get both those answers about the judges, as well as whether we should get feedback on every transaction, if that's possible, Bill, why don't we--we'll go right to left again.

MR. BAER: Fine. I'll be brief here. I think in fact--and I talked about this a little bit in my written statement--20 years ago, 23 years ago

when the Guidelines were first adopted, there was a tremendous divergence between agency enforcement articulated policy, and the old court cases, *Pabst* among others. What we've seen over time I think is a tremendous improvement, integration by the courts of the Merger Guidelines concept. So there is more, in effect, communication between agency enforcement objectives and standards employed by the courts. So I think the trend line is very, very good. You do have a mixture of experiences among the judges in terms of this, but the fact that these guys, men and women, often have to handle very complicated intellectual property issues, that sort of stuff, they are generally a smart, straight-thinking crowd of people, and in my experience, having agency-articulated standards that other courts have adopted does help provide more of a frame of reference than one had 15 or 20 years ago in litigating a case before the federal district court.

The fact that the agencies, the Federal Trade Commission, has the ability, through its adjudicative or administrative decision-making process to get thoughtful decisions out there--the

Toys 'R Us case was one I worked on, reviewed by the Seventh Circuit--helps in another way I think to give additional guidance to the courts as to what's appropriate and inappropriate.

And again, I'm a big fan of transparency. I think we found that there are ways of giving some indication of what led to an agency decision that's helpful without getting into some of the confidentiality problems that Bobby alluded to earlier in his testimony.

MR. RILL: I think it's a serious question. The obligation on the part of the agencies and the bar and the economic community to develop and explain standards that are understandable and usable by those who are not specialized in the field is an important responsibility and one, for example, that was one of the three legs of the paradigmatic trilogy that Tim Muris put out in his George Mason program, but the option, it seems to me, is not to have a specialized court; other countries have tried it. When I first broke into law practice, the Administrative Conference of the United States was recommending a trade court, and it never got legs, as it were, and I

think that was a good thing. I think that what Bill says about the quality of the judges foretells a greater confidence, provided we do our work, in outcome than would a specialized court. There are some specialists I don't think we'd want to give a lifetime appointment to in that aspect.

Having said that, I do think the obligation is the Bar's. The economic community and the enforcement agencies should develop and communicate, transparently, standards that are appreciated and workable, as well as good and flexible to make the system run.

MR. SCHEFFMAN: Well over half of my work as an expert witness is in antitrust, intellectual property contracts, and complex damages. I don't know how any human being could adjudicate a patent suit actually, given the state of the law and the complexity.

The beauty of the Guidelines is that they give judges a roadmap for market definition, which is important, that *Brown Shoe* didn't, and they can do it. That's why critical loss continues to be important even though the agencies, at least the

economists, don't like it. It is the test. It is a test that you can actually implement with the right evidence. And then the judges understand. It's interesting that they don't rely on *Philadelphia National Bank*. They've relied on the more recent district and appeals court precedents, and it's basically--you have to prevail on market definition, you have to tell a story, and you have to have the facts to back it up. That's what a good judge does. Who did what to whom, and do the facts support it? And I think what we're doing in antitrust is not highly complex compared to some really complex contract disputes, or certainly a patent suit, and I think they're quite able to do that. There's a lot of good material available for judges on antitrust, on statistics and other things for them to read.

So my own experience is, they're quite capable and give great clarity to the whole issue, boiling it down to what the key factual issues are.

MR. WILLIG: I have high hopes myself. Maybe they're misplaced. But it seems to me it takes a long time for collective wisdom to make its way into the courtroom and to influence judicial

decision-making. It's a very high hurdle for ideas to jump from, say, academe, to the courtroom. It's also a serious hurdle for ideas to jump from government policy, government guidelines, into the courtroom, and yet, from judicial decision to judicial decision, there's much less of a barrier to that wisdom's spread.

So when I see a decision like *Arch Coal*--and again, I'm no expert on those facts, although my partner, Meg Guerin-Calvert, tells me that even the facts were right, not just the theory--but the judge's understanding that came through in the decision about how to analyze coordinated effects without necessarily embracing the Guidelines, *per se*, but very much consistent with the guidelines as well as academic thinking, I think is a great beacon for the future. I can't imagine that subsequent judicial decisions that deal with coordinated effects, either pro- or anti-enforcement, can ignore just the beacon of light that is shed by the *Arch Coal* decision, and I imagine that, soon enough, *Oracle* will have even better decisions, with better reasoning on the unilateral effects.

I think we've seen some pretty good decisions on market definition, so I think it's slow, but maybe, at this point, relatively sure, pointing the way toward our best wisdom, making its way systematically into judicial decision-making.

CHAIRPERSON GARZA: Thank you very much.

Commissioner Warden?

COMMISSIONER WARDEN: Thank you.

Professor Scheffman says in his written statement that the agencies, he believes, impose too high a burden in the proof of efficiencies. Mr. Cary, who's on the next panel, makes somewhat the same point with respect particularly to R&D efficiencies. And we had a witness at a previous panel who had been involved in a biotech merger, and without getting into the details of the merger, he obviously was disappointed, having represented the company. He made the point that he thought the Agency imposed too high a risk barrier to accepting what good he thought was shown would come from this merger, and too low a risk barrier as to any possible anticompetitive effect. If that is true, that doesn't sound like good enforcement policy. And I

wonder if anyone would like to comment--I'll start with Bobby--on whether this is in fact what's happening, and what could be done about it if it is?

MR. WILLIG: I appreciate the logic of the statements that you're repeating in your question. I do think the reality of antitrust decision-making does have lots of uncertainty and risk factors implicitly or explicitly built into it, both on the efficiency side and on the evaluation of competitive effects. And I do think that some decision-makers are quite willing, at least in the inner circles, to work forward with their colleagues and with their staff in recognition of those degrees of uncertainty. It's harder to express that kind of uncertainty publicly for fears of undermining legitimacy of the entire enterprise.

For example, when it comes to entry--and this is something that constantly worries me--the guidelines talk to a frame of analysis for entry which is quite persuasive, I think, to economists generally, and yet in practice there's nothing like evidence of actual, honest-to-goodness entry to persuade people, and if there is not actual entry,

then the underlying factors that economics points to for the power of entry as the competitive force tend to get discounted a lot because they seem relatively speculative, and they shouldn't be I think as a matter of economics, but inevitably they have to be viewed as less certain a sign than actual entry.

Efficiencies inevitably appear the same way. They're all, "Well, tomorrow, under these new circumstances, we will be able to do that." It's intrinsically speculative unless there's a track record. But if there's a track record, why is the merger necessary anyway to get those efficiencies? So I think there is inevitably risk. I don't see a particular tilting away from or in favor of one kind of risk or another, but I do think risk afflicts the entire enterprise inevitably.

MR. SCHEFFMAN: Well, as I've written and said briefly, I mean, as those who do M&A, or I, as a strategy investor, would look at the merger benefits. It has very little to do with what we look at in antitrust, not that what we're looking at in antitrust is irrelevant. When we get to litigation, when we get to pass-through and things like that and

changes in variable cost--so it's long been stated, and two people at the FTC wrote an article saying that merger efficiencies are necessarily speculative, and I always wondered, "What do you think we're doing in projecting the competitive effects?" Nonetheless, merger-to-monopoly I don't think is speculative, if that's what it is, but beyond that, it's speculative. It depends on the evidence.

So I do think--and I've made speeches and comments about this--the agencies take into account efficiencies in the general sense up front if the parties put them forward--is where we're doing the deal. And this is why--and let's not talk about pass-through and things like that; we have arguments about that--but this is a good deal, and this is why that is a good reason that some matters don't get second requests when they otherwise would based on the thresholds. It is a reason that the agency sometimes doesn't pursue an enforcement agency action. It's certainly a reason that the agencies can be flexible in their remedies in some cases--and I point to pharmaceutical mergers, where the FTC has been very creative in accepting remedies, and that's

because everyone accepts--and I don't think there's much dispute--that those mergers on average have been efficient.

I think the problem is, there is still a disconnect between the lawyers and the economists on the outside, and how much effort do we want to make to put forward what the story is really about? We're not talking about a $500,000 study. We're talking about putting some flesh on. No, this really is a good deal, and you should count it, and keep that in mind all along, even if we get to the end, if we're negotiating remedies, then we've made that case. I don't think what we've done in terms of litigation is very productive in thinking about that. I don't think it makes sense for the court to ignore fixed cost savings and things that fall into this pass-through trap. Nonetheless, I don't think we should go with *Superior Propane* either, so I don't think we're there. Efficiencies aren't dealt with properly yet.

COMMISSIONER WARDEN: May I ask one more question? This is of the lawyers; do you see any policy objection to a statutory change that would

enable the kind of transparency that Bobby's talking about through the use of protective orders if such a change is necessary to enable that transparency to occur?

MR. RILL: I would have to, Commissioner, give you a rather first-cut answer, and I think that first-cut answer is, no, I don't think it would be helpful to have a legislative change in that area. I think there's much that can be done within the framework of existing legislation to achieve the result, which I think is a good result that you're looking for, to create more transparency.

I think to develop some kind of legislative skeleton for that--I don't mean that pejoratively--for that kind of cure might be somewhat worse than the disease. I also think, as a practical matter, you might find a more than modest objection from the business community to that kind of a legislative approach.

MR. BAER: Commissioner Warden, I agree with Jim Rill. I think, at the end of the day, that if one is willing to compromise a little bit on the individualized company data that one puts out to

explain or justify a particular action or a decision not to act, if you're willing to accept a little less than that in the public disclosure, you can still advance the transparency ball a long way and avoid running into the buzz saw of legitimate business and also antitrust concerns about disclosing too much and the effect that could have on competitive behavior.

CHAIRPERSON GARZA: Thank you.

Commissioner Delrahim?

COMMISSIONER VALENTINE: A question--

CHAIRPERSON GARZA: Well, we only have five minutes left, so can we go around--I'd like to just stay in order if we could. Commissioner Delrahim?

COMMISSIONER DELRAHIM: Thanks. And I have two questions. One, a quick one from the panel. If each of you were going to change three things in the Merger Guidelines, and each of you do not have to have mutually exclusive answers, what would they be, and what would you recommend the Commission consider either changing or studying further? Mr. Willig?

MR. WILLIG: Not a word.

[Laughter.]

COMMISSIONER DELRAHIM: Mr. Scheffman?

MR. SCHEFFMAN: I don't think the--I think what the DOJ and the FTC are doing in trying to elaborate better what the practice is, is very important, and you really can't put that into Guidelines. I think that's the only--I don't see anything, even though I actually think there's an analytical mistake in the Guidelines, I don't think it's worth changing. I don't think it's in the Guidelines. I think it's providing more clarity about what really goes into enforcement decisions. That's what the DOJ and the FTC are apparently going to do. I think that would be very welcome.

MR. RILL: I think Bobby and I, and certainly when we get to efficiencies, Bill Baer, and David, are not necessarily totally unbiased witnesses. But I'll have to take your question as you put it, if you had to change something, what would you change? And I think what I'd change would be the footnote dealing with unilateral effects, testing next-best substitutes, and put it into the text before I got into market-share testing of next-best substitutes.

[Laughter.]

MR. BAER: Too radical, Jim, too radical.

[Laughter.]

MR. BAER: Makan, what I would do would be, basically, what Dave Scheffman says, push the agencies to get out the interpretive guidance. The annotated Merger Guidelines really will be helpful to practitioners in the business community, and so that's the direction in which I'd push them. It doesn't necessarily involve language changes to the Guidelines themselves.

COMMISSIONER DELRAHIM: Perfect answer for my second question. When we were doing the 2004 merger data project at the Justice Department, one of the problems we ran into were just dismal agency records in the *ex post* study of data, of the HHIs, of deltas, whatever. And as each of you have worked in the agencies, you know, depending on the merger wave and the time resources, sometimes you're over with this, off to the next issue.

One thought might be have Congress require the Justice Department to keep certain data, so moving forward--now as the past in certain mergers and transactions have occurred--and frankly, I'm

probably more of a student of Edwin Rockefeller than Rockwell and Donald Trump and others, and I enjoy his critique of this process--but if Congress was going to request that, first, would you think it's a good idea to require the agencies, every five years, to look back and provide some annotative guidance and transparency for the practitioners?

And the second, if you think it is a good idea, what kind of information would be useful that the agencies could keep? And I understand you have additional suggestions on confidential data that the agencies keep as part of that process, but what would be some suggestions you each would have, given your past experience with the agencies?

MR. WILLIG: Well, the word "Congress" does frighten me here in the casting of your question. It seems to me that, given the moral persuasion that you have at your command as a very highly regarded Commission, you have the opportunity, I think, to be very persuasive to the agencies to adopt a more organized course of self-reporting, both for the sake of transparency and public relations now, but also for the sake of posterity. A suggestion: every time

a case substantial enough to go to a second request resolves one way or the other, there should be some internal report that should include at least information on the outlines of what the best view of the relevant market was, what the concentration numbers looked like, what the foundation was for the assigning of shares to market participants, what the competitive effects theories that were considered were--

One can think about the finding of form that would lead to a couple of pages, single-spaced, of answers nothing more elaborate than that, and a policy by the agencies, encouraged by the Commission, to go forward with a record-keeping operation of that kind. I think it only helps the process, and also help to focus the minds of the decision-makers on, "Well, we'd better be thinking about what we're going to write down on that closing report as we're making our final decision. Maybe we do have to figure out what our best crack at the relevant market was," instead of just, "Oh, well, there are a lot of different options, and we don't really have to decide that now, do we?" which I think helps to encourage

fuzzy thinking at the end, rather than recognizing that, "Well, we're going to have to write something down here. We'd better actually close and come to a consensus view on what the right answers are."

COMMISSIONER DELRAHIM: Mr. Scheffman?

MR. SCHEFFMAN: Let me say that, having been there, the data project, you know, the release of the so-called "secret guidelines" data was only possible because of Malcolm Coate, who's sitting in the back, an FTC economist who had been studying the numbers a long time and could actually lay his hands on them. And part of it was what was actually still in the computer. We could find a lot of the memos. Now that everything's in the computer, I would hope the agencies are keeping all that stuff, that they're not erasing it.

Bureau directors and agency heads regularly report on what percentage of the transactions get second requests and provide guidance in speeches. I think we did the release of the, quote, "secret guidelines" data. If it becomes an issue as to that they felt a need to do that sometime in the future, I think they now know how to do it, won't be able to do

it much more easily, because things will be in the computer, so I don't know that there's any need to do it, to require them to have it. They do have it going forward. It's in the computer. All the memos are in the computer.

COMMISSIONER DELRAHIM: It's not so much the percentage of second requests and actions, because that's in the annual report to Congress, as Mr. Baer and I sifted through back in '99, too long. But it's more directed to some of the questions from the Commissioners. Are the agencies over-enforcing, under-enforcing? What are we looking at five years after a particular matter? What are some of the transactions where they have challenged? What were the numbers looking like? What were the market definitions that they were going to, and looking backward five years? Maybe every five years that would not be a bad Government practice.

Now, there was some hesitation of Congress requiring that. Having spent a little time in both branches, people and personnel change, and if Congress requires that everybody remains focused, rather than thinking it's a policy of one

administration or another--

Mr. Rill?

MR. RILL: I think this Commission should encourage the kind of effort that Bobby's suggesting over and above kind of the simple data point or more than data point retention that I think David's suggesting. I think some kind of collection of rationales, decision-driving rationales for major areas, areas where perhaps the second-request screen is a good one, would be useful. Whether Congress should do it or not--you've spent more time up there than I have, Commissioner, and it seems to me that the first question is, will Congress pay for it? I say that only somewhat facetiously.

MR. BAER: Federal mandates? I basically agree that it ought to be done. I think it's good public policy to have it done. My sense is, if this Commission suggested that it be done systematically, that would be enough to--once institutionalized it gets kind of easy, and it would save you and your future colleagues at the Department the kind of efforts you had to go through to assemble the data that was released in '03.

COMMISSIONER DELRAHIM: I should give credit where credit was due. The FTC's data were orders of magnitude better than DOJ's data.

MR. BAER: But I think that may be, in part, the decision-making process the Commission has because it's a five-member, you know, five-headed monster that really requires a--excuse me--more of a detailed presentation of the facts in evidence, because there are a number of people with a statutory responsibility to review it, and so you probably get more on paper out of the FTC in my experience, than you necessarily would at the Division, because it's a more streamlined pyramid.

MR. RILL: Let me just pick up for one second. Do not underestimate the impact that recommendations of this Commission might have. One need only look back at the Kirkpatrick Commission that studied the FTC and the impact that that had. And I would like to say, even in some sense the ICPAC recommendations and the extent that they have had influence on a more global stage--

What you say is going to make a difference. We don't need Congress to enact it for there to be an

impact from this Commission.

CHAIRPERSON GARZA: Thank you.

Commissioner Cannon.

COMMISSIONER CANNON: Thanks.

Jim, I think I understand your position on the hesitancy of getting the Congress into any of this merger business. A couple of weeks ago we had a hearing on the clearance process. I know Bill referenced that in his testimony. I kind of hate to let you guys leave without asking you about that, about how you really solved that. There was a lot of discussion about how that agreement obviously was not able to be effectuated. We even toyed around and asked a couple of questions about some sort of statutory mandate that would not be really complicated, say a decision has to be made in five days or seven business days or something like that. Is that a simple enough approach, or how do you really resolve this? You know, we spent a lot of time on discussing it, and we went round and round, and didn't have a good answer.

MR. RILL: I think--I haven't even really thought about a timeframe on it. I think some kind

of congressional delineation of authority would be something close to a disaster, given the structure of Congress itself, not even going to an *ad hoc*--

COMMISSIONER CANNON: I'm not talking about dividing it up; I'm talking about just simply a timeframe, not a subject frame.

MR. RILL: Well, the fact of the matter is we have a timeframe, and maybe it's a timeframe that doesn't work very well, and in one particular case I'm involved in right now it didn't work very well. But I think, quite frankly, that the failure of the agreement to become effective could be considered more episodic. I know that Chairman Majoras made some commitments in her confirmation hearings, but one might look at another way of doing the same thing, because the failure of that particular agreement, we all know, was driven by a very small portion of people on the Hill, some of whom aren't there, and was driven by the time circumstances of-- important other factors being considered at the Department of Justice. Rather than have Congress set a timeframe to it, which would have some downsides as to perhaps hasty decisions for positive forward-

moving, in-depth investigations that aren't justified, the time factor would give me a lot of problems. I think they ought to resurrect, in some other form, the agreement.

MR. BAER: Steve, I agree with that. I think resurrecting the agreement, that has the elements of getting from here to there and dealing with a problem that, while not occurring all that often, is intolerable when it does. You had your panel. I'm not going to repeat any of that, but if the agreement that was announced had timetables and a decision-maker, he would go to an outside mediator to make a decision in the event you couldn't get from here to there. That's all you need.

You've got to have good faith on both ends in terms of how you're going to divide it up at the front-end, and then a dispute resolution mechanism that's publicly announced, and people know what the time deadlines are, and agencies really are forced to observe them. Right now it's still a little bit too much of a black box, and so whatever timeframes are articulated don't have to be observed. There's no accountability on the part of the agencies to talk

about what their average time in decision-making is when there's a clearance dispute. So I think there's a way to get from here to there, and it really is following a model of what was tried and didn't quite get implemented for too long.

COMMISSIONER CANNON: David or Bobby, either of you guys have a comment on that?

MR. WILLIG: No.

COMMISSIONER CANNON: I didn't think you'd care.

MR. SCHEFFMAN: Well, let me say something. I think it's really quite shocking, but that's the way competition works. I really think it should just be an arrow; you have so much time, and it's determined by the arrow; spin, and it's your turn. Another benefit of that is that we would get more consistency between the two agencies as how they look at things, and you know, when they increase the amount, they talk to one another. I think they can work it out, but you've got two days or something. You work it out, or it's the arrow.

COMMISSIONER CANNON: I'll yield my 30 seconds.

CHAIRPERSON GARZA: Thank you, Commissioner Cannon.

Commissioner Burchfield?

COMMISSIONER BURCHFIELD: As the last questioner, everything has probably already been asked, but it hasn't been asked by everyone yet.

[Laughter.]

COMMISSIONER BURCHFIELD: I was intrigued by Mr. Rill's written testimony, where he refers to the discussion in the *Oracle* and *Arch Coal* cases of the weight the court was giving to consumer testimony. And I'm just interested in each of your quick reactions to the question of whether the agencies place too much or not enough weight on consumer testimony as compared to the economic analysis. I think I can predict what Mr. Willig and Mr. Scheffman are going to say on that question, but I would be very interested in each of your reactions to whether the agencies are over-weighting consumer testimony and also whether they over-weight the emphasis they place on the so-called "hot documents."

MR. BAER: My sense is no, that there is, as someone, I believe Jim Rill, said earlier, an

evolving process, where you learn from questions courts start asking about where the customer assertion is coming from, and is it factually based? And you need to go back and maybe get a little better at it.

Any litigator loves to hold up a hot document and wave it in front of the decision-maker. It's part of the fun of being in court. But at the end of the day these cases are being reviewed by decision-makers who are looking at a bunch of different factors. If you look at the FTC enforcement stats that were put out for the '96 to 2003 period, hot documents didn't appear to be anywhere near as outcome-determinative as credible customer complaints and entry. You know, was it easy, was it difficult? And I think that's as it should be.

But the way a business looks at how it operates, how it sees its competition, how it defines its market, what it looks forward towards in terms of what its competitive strategy is, and what it sees will likely result from this transaction, if it happens--you know, companies are much better--I think

sometimes the outside investment banking advisers are sometimes less good, but the tendency to tout the pricing muscle that will result from a transaction, is relevant. It causes you, when you see that in a 4(c) document, to decide that there ought to be further inquiry, but it ought not to be, and in my sense it is not, outcome-determinative. The other factors we articulate in the Guidelines get a good hard look, as they should.

MR. RILL: I think I have predicted my answer in my statement. I think the key is not that consumer testimony or customer testimony is over-weighted by the agency. I think it might be wrongly weighted by the agencies in some particular cases. The agencies and the courts and the parties and legal and economic fraternities and sororities have come a long way from the days when, in one particular case I'm aware of, a staffer for one of the agencies went to a trade show and handed out little slips of paper, "Do you not like this merger? Isn't this merger bad?"

[Laughter.]

MR. RILL: And then collected a bunch of

them and dumped them in on the agency decision-makers, and the rest was history. I think we fortunately have come a long way from that particular experience.

The key, as I've said before, is informed customer testimony based on some kind of empirical analysis. I think that, to separate it from economic analysis, is kind of a wrong dichotomy. It's part of the total analysis of the case.

Hot documents--one has to look at the nature of the document, almost like customer testimony--is it based on fact or is this just an aspirational view of some even perhaps senior management person who really wants to crush his competitor? Well, okay, that probably is not an uncommon view in the business and perhaps even the legal community, God forbid. But one needs to look at what the basis for it is before it becomes at all useful.

I had a terrible case where one plus 12 equaled market power, and it didn't sway the court from giving the case to me.

MR. SCHEFFMAN: Commissioner, briefly, I agree with Mr. Rill; this is part of the economic

analysis, certainly what I would look at. But I think this goes back to my earlier comments about having smart generalist judges. This sort of evidence is what judges see all the time in all sorts of cases. I think what's become obvious to them is that the witnesses who appear for each side, the customer witnesses, didn't come out of the earth. They have an agenda. They were prepped. Sometimes they had their arms twisted.

If you look at the testimony of the customers in *Oracle*, you would see why in my view--I worked on that matter--why the court found them really not credible and really more supportive to the parties. So I think the judges are very good and have gotten past that. *Oracle* and *Arch* are clear cases where you, in one case, have hot documents, and, in the other case, you have lots of customers, but get past to realizing that's not going to be determinative; there are other key facts that have to be determined.

MR. WILLIG: I think the agencies themselves are very aware and very responsible generally about understanding whether customer complaints and whether

hot docs are just puffery or locker-room talk or impressionistic, as opposed to being genuine, important sources of real facts about the way the businesses work and what the combination is apt to do.

So I think the agencies have it right, except when the agencies are thinking toward litigation, and depending upon the personalities of the decision-makers and the posture of the case. Often, litigation is the way the front office or the Commission is going to be thinking about the enforcement decision. Can we win in court? What's a judge going to be looking at in reacting to the kind of case that we might be able to put forward? And from that point of view, at least in my experience, those looking at potential litigation are thinking about the judge or thinking about a jury and thinking about what the impact would be of customer testimony and the hot docs, and allowing that to affect the decision-making within the Agency, even though the agency fundamentally knows better than that.

And so what I look toward for seeing this improving further and being entirely resolved is the

increasing sophistication of the bench, so that even those inside the agency looking toward litigation are looking toward a more rational, calmer, better informed process in court.

COMMISSIONER BURCHFIELD: Thank you, very helpful.

CHAIRPERSON GARZA: Thank you, gentlemen, for subjecting yourselves to us this morning, for your thoughtful comments and your thoughtful statements. Your statements will be posed on the AMC website, as will the transcript of today's hearing. I wish I could, but I can't promise you that we won't be back to you with specific questions, and we hope that you will remain interested in the work of the Commission.

Thank you very much.

[Recess taken from 11:46 a.m. until 12:48 p.m.]

CHAIRPERSON GARZA: This is the Antitrust Modernization Commission hearing on the treatment of efficiencies and merger enforcement. Let me briefly state how it is that we will proceed this afternoon.

First, each of the panelists will be given

about five minutes to quickly summarize your written testimony, which all of the commissioners have received and hopefully have had a chance to review. After each of you have delivered your summaries, then we will turn to the Commission for questioning. Commissioner Kempf will lead the questioning for the Commission for 20 minutes, about 20 minutes, and then following that, we will give an opportunity TO the remaining commissioners to ask questions. We'll initially ask the commissioners and the witnesses to be brief, and each of the commissioners will have five minutes to ask questions.

It looks like we may have a less than full complement of commissioners this afternoon, so we may be able to take a second round of questions after the first. But we'll try to keep the first to about five minutes.

There are lights on the tables--green, yellow, and red. When you see it start to blink in yellow, it means you have one minute remaining, and when it's red, it means your time is up, and so we would ask you to try to wrap up whatever you're saying at that point in time.

With that, let me start with our witness who is a representative of the Justice Department this afternoon. Mr. Heyer, would you like to go first, please?

MR. HEYER: Sure. Is this on, or do I press it?

CHAIRPERSON GARZA: It should be on by itself.

MR. HEYER: Okay. First I wanted to thank you for inviting the Justice Department to provide a representative. It's a privilege and an honor to be speaking to you and answering your questions, which I look forward to, actually.

I wanted to make three brief points at the outset, covered to some extent or another in the written remarks. One is to emphasize again that the Department of Justice, the Antitrust Division that I work for, does take efficiency claims very seriously, and beyond that, takes efficiencies very seriously. We actually go so far as to probe into whether there might be efficiencies even in some circumstances where they're not specifically claimed--although it obviously helps a lot to have some assistance from

the parties.

The second point that I would make is on the issue of cognizable efficiencies. Efficiencies can't simply be stated or asserted. We actually need some evidence to support the fact that there may be efficiencies from what might otherwise be a troublesome merger, in particular, raising the size of the alleged efficiencies and then saying if you only credit one-third of this number, it does not by itself transform unsubstantiated claims into substantiated ones.

[Laughter.]

MR. HEYER: Not to play it out to its logical extreme, but you can imagine that could create some problems and perhaps get every deal cleared, right?

And then a final point that I'd make related to all of that is that it's more facts than theories that really drive the analysis. I think that most of the folks inside the Antitrust Division who make decisions understand pretty well by now what things are efficiencies in theory and what things are not efficiencies in theory. The real driver in most

matters is demonstrating the extent to which claimed benefits from the merger really are merger-specific, and, of course, estimating as best one can the magnitude of those benefits.

That's more where the problems tend to arise, and the disagreements arise, and judgments inevitably have to be made, not so much with the issue of, does this count or not.

So that's really all I have to say.

CHAIRPERSON GARZA: Okay. Thank you very much.

Mr. Salinger?

MR. SALINGER: Thank you. Thank you for asking me to be here today.

I have to note at the beginning that what I say today represents my views and does not necessarily represent the views of the Federal Trade Commission or any of the individual commissioners.

I have submitted a written statement, as you know. I'll summarize it briefly.

As you no doubt are aware, I'm relatively new to the Commission. I can tell you, though, that I have been given a very clear message from the

Chairman of the Commission that efficiencies are to matter in our analysis. And I can tell you that my staff analyzes efficiencies and takes them quite seriously.

Now, there may be some perception out there that, that statement notwithstanding, efficiencies don't play as much of a role as we say. But I think that's a mistake, and I think the explanation of it is that efficiencies often enter our analysis in a somewhat less formal way than the Guidelines would lead one to believe. When we assess a merger, always in the back of our mind is the question of why do the parties want to do this deal. And the competing hypotheses are that they're trying to create efficiencies, or they're trying to create, preserve, or extend market power.

And so if there's some credibility to the efficiencies that will be achieved by the merger, that has a big effect, I believe, on how the merger comes out.

Now, sometimes the treatment of efficiencies is relatively informal, and the question then becomes, well, why doesn't it enter the formal

analysis more than it does. And I think part of the explanation is that the evidence that the parties give us about efficiencies is often not very good. And, you know, one of the problems we find is that companies say they're going to save a lot of overhead expenses. You know, we only need one CEO, we only need one CFO, one marketing director. And that's true. But what's also true is that overhead expense as a fraction of total expense is not systematically lower for large corporations than for small corporations. So these aren't really fixed costs, and I don't see any reason to suppose that those savings are going to come about at all, or certainly not to be large.

Now, the sort of efficiencies that we would--at least I personally would expect to be more important in mergers is knowledge transfer. You have two companies that produce the same thing, and, you know, one of them knows how to do it better than the other. And when they merge, whoever has the better knowledge--typically it would be the acquirer, but it doesn't have to be--is going to transfer that knowledge to the other company.

That might be a hard kind of efficiency to communicate to us in a credible way, because it might require sharing with us information that is proprietary information. And, of course, I understand that confidential information can be shared with us, but probably parties are suspicious that what they tell us in confidence is not guaranteed with probability one not to get out in some way. So I don't necessarily have a solution to that problem.

I do think that when we consider efficiencies, we do have to think hard about the burden of proof. On the one hand, I agree completely with Mr. Heyer that we can't credit efficiencies simply because the parties say they're so. On the other hand, when we look at anticompetitive effects, those are inherently probablistic. When companies make decisions about a merger, they're making that decision under uncertainty, so they're often taking bets on the realization of efficiencies. But I think that if the prospects for realizing efficiencies are sufficiently probable that the board is willing to consider them in deciding how much they're willing to

pay, then we also need to take those into account, at least probablistically.

So I--

CHAIRPERSON GARZA: Thank you--oh, I'm sorry.

MR. SALINGER: I was going to say that's the end of my comments.

CHAIRPERSON GARZA: Thank you.

Mr. Rule?

MR. RULE: I'm next, okay. It's a pleasure to be here, Madam Chair and members of the Commission. My statement spends a fair amount of time addressing one of the questions that the Commission addressed to the panelists, which was whether the standard for merger enforcement should be consumer welfare or total welfare. And a good deal of my statement goes through the fact that I first met that question with some surprise, because back in the days--at this point, long ago--when I was in the Antitrust Division, we thought consumer welfare meant total welfare, because we had read *The Antitrust Paradox*, which is what, of course, the Supreme Court quoted in saying that antitrust was a consumer

welfare prescription, and assumed the Supreme Court had read Bork as well, and, therefore, viewed the standard as being total welfare.

The statement also indicates that, you know, whether you want to recognize consumer welfare as its original meaning or if you want to take what apparently over the last 20 years has converted the term to a much narrower notion of maximizing consumer surplus, the fact is that the standard should be consumer welfare. First, under either standard, one is concerned about allocative efficiency, and certainly, markets, if left free from private or governmental interference, for that matter, will tend to push prices toward marginal cost. And when prices equal marginal cost in an equilibrium, then resources are allocated efficiently, at least in that market.

There's a benefit to that, because in a static sense that maximizes surplus, sort of holding production costs as being fixed. However, in the real world production costs are not fixed, and society benefits when market forces have their natural effect and push people towards reducing production costs, reducing costs generally, improving

the quality of goods. And the reason that producers do that is that their efforts are rewarded as a result of their ability to earn rents--surplus--off of the assets that they create and the efficiency that they realize. And it would be a mistake for antitrust to ignore that.

Now, that doesn't mean that antitrust ought to go in and regulate private creation of efficiencies. The fact is that the market's better at rewarding or punishing those individuals in terms of the productive efficiency they create. However, antitrust should recognize the benefit of productive efficiencies and the surplus it creates and be concerned about total surplus.

Having said that, exactly how the law ought to incorporate productive efficiencies, as I explain in the paper, is not altogether clear. After all, Judge Bork, for example, thought that you should not consider productive efficiencies explicitly. The reason was not that he thought they were irrelevant--in fact, he says that they are very relevant--but, rather, because of a sense that I somewhat share, that it's a fool's errand to try to calculate with

precision allocative inefficiency and compare it with precision against productive efficiencies, and that we might be better off having a standard that tolerated, for example, some increases in price so as to give parties freedom to generate productive efficiencies.

That's what we tried to do--or that was sort of the beginning point in the 1980s. I'd point out that we decided that because an order of magnitude sort of comparison of allocative inefficiency with productive inefficiency could be done. We introduced the notion of recognizing efficiencies. I also go through and point out some of the bad effects of this, which I think are, one, it confused people into thinking that we were following a consumer surplus standard and that all that mattered were price effects. I think, two--which meant that, in effect, the thresholds for condemning anticompetitive mergers potentially came down. And the second thing was that it resulted in a sort of asymmetry that, while the thresholds came down in part because of the notion that parties could prove productive efficiencies, the approach, notwithstanding what the people on either

side of me said, at the agencies tends to be very skeptical of efficiencies.

So, as a practical matter, I would think that today the rules probably generate false positives in terms of condemning mergers that actually benefit total surplus and ultimately consumers as a whole.

So, with that, I'll stop, and I'll be happy to answer questions about my recommendations and what I think the consequences of this are. But I'm sure that others who have a different view of consumer welfare have something to say.

CHAIRPERSON GARZA: Thank you.

Mr. Cary?

MR. CARY: Thank you, Madam Chairman. I think it's a useful segue from Mr. Rule, because I think I do have a slightly different view from the one that he's expressed in his paper and that he expressed here this morning. My view is that the Merger Guidelines have it right.

I don't know that I always felt as confidently of that as I do today, but after eight years of seeing the Guidelines in action, being on

both sides of presenting issues under the Guidelines, it's my view that the basic trade-offs made in the Guidelines were right. It's also my view that the process of actually doing the efficiency analysis that is set forth in the Guidelines is more manageable and more administrable than one might have thought going into the process of creating the guidelines analysis in the first place.

First, I believe that consumer welfare is the appropriate standard. There is a consensus around that, I believe, notwithstanding Mr. Rule's comments. I believe it's consistent with the legislative history of the antitrust laws; it's consistent with the underlying policy of these laws, and it's consistent with the court decisions. And harkening back to a question that Commissioner Litvack asked this morning, I think it is quite central to the public perception of what the antitrust laws are about: preventing anticompetitive combinations that allow producers to raise prices to consumers. That's what the man in the street believes, and that's consistent with the history of antitrust, and it's not inconsistent with an

efficiency standard based on consumer welfare. Not only are the legislative history, the court of public opinion, and the courts in accord with this view, but this view is consistent with an economic view under the antitrust laws, an economic view in reviewing mergers and the appropriate economic test for reviewing mergers. And I would defer to Professor Baker and Professor Salop to elaborate on those points, as they do in their excellent papers.

Part and parcel of the consumer welfare standard is the pass-on requirement: that consumers be the beneficiary at least of some of the efficiencies that are being generated and at least in a magnitude sufficient to counteract a price increase that might otherwise result from the transaction.

Also part and parcel of this analysis is the merger specificity requirement, which reinforces the idea that, if consumers are going to get the benefits of the cost reductions even without the merger, they should not have to suffer the increase in market power that comes with the merger. This test is also likely to reduce the possibility of error in merger enforcement, because it ensures that an

anticompetitive merger is not approved on the altar of efficiencies that will be achieved in any event. And on this I'll harken back to a comment made by Commissioner Kempf this morning, because I think the example that he gave of *Staples* going out and acquiring firms outside the market--namely, mail-order companies--and realizing the same efficiencies that it might have realized by acquiring Office Depot without the anticompetitive impact in the localities where retail competition was intense, proves the point.

The courts have done a good job in analyzing efficiencies presented by parties. In those cases where the efficiencies have not been accepted, cases such as *Staples* and *Arch Coal*, *Drug Wholesalers,* and *Heinz*, the courts have done an admirable job in understanding the thrust of the Guidelines, but also applying them in a very practical way. But I say that with a caveat. The efficiency arguments that have faltered so far have faltered on relatively discrete, identifiable characteristics. Either the efficiencies were of fixed-costs and, therefore, would not likely impact prices, or they were simply

not verifiable or merger-specific.

The hardest part of the Guidelines test has yet to be tested in the crucible of litigation, and that is the trade-off between a tendency towards an anticompetitive price increase from enhanced market power and the marginal cost reductions or efficiencies. And it will be interesting to see how the courts deal with this question when it comes squarely before the courts as a necessary part of a decision on a merger. My recommendation would be that we let that happen within the courts and we gain some experience with how that question will be litigated rather than making dramatic changes in that standard as part of the Guidelines or as a legislative fix.

While the question was addressed in *Staples*, it was not a critical part of the analysis, because the remaining efficiencies, after taking into account specificity and verifiability, were not so great as to require an answer to the question. Nonetheless, there was a pass-through analysis. It was done on the basis of econometrics. And while I think it worked well, there was a lack of really robust data

to do it as well as one might like. And I look forward to seeing how the courts grapple with that once they find verifiable and merger-specific efficiencies going forward.

CHAIRPERSON GARZA: Thank you.

Professor Baker?

MR. BAKER: Thank you, Madam Chairman. It's nice to see so many old friends in the room.

My overall conclusion is that there's no serious problem involving efficiencies in merger analysis that would call for intervention by your Commission, and that, in particular, there's no need to recommend any legislation to address anything concerning efficiencies.

My written testimony makes several points. I will sketch a few of them now. One is that the federal courts are grappling with how to consider efficiencies, and they should be given the opportunity to address that question fully. Based on the cases I've worked on and others I've read, I believe that merging firms often present sophisticated economic evidence as to efficiencies, and when they do, the courts are engaged fully in

evaluating it.

The courts are beginning to develop comprehensive standards for doing so, and they commonly draw on the Horizontal Merger Guidelines. And while I don't agree with the resolution of every case, there's no reason to think the courts as a whole are moving in an inappropriate direction. And I don't see any need for a legislative recommendation in that area.

I also discuss in my written remarks that efficiency claims should be evaluated using a consumer welfare standard, which is the right test, even if the ultimate goal is to maximize aggregate welfare. And I'm here using consumer welfare in the sense of consumer surplus in the partial equilibrium framework. And when I use aggregate welfare standard, I'm talking about total or aggregate surplus.

There's this terminology confusion that Mr. Rule alluded to. I think the interesting point is that those who favor the aggregate welfare standard find it useful to wrap themselves in the mantle of consumers when they're talking about it, and that

it--that the--even when what they're actually talking about is a standard that in theory would let shareholders take money from consumers' pockets, they may use the--the shareholders may use that money to buy other things, but it doesn't make the injured consumers feel any better.

In any case, the choice of welfare standard could in theory matter, and there are a number of ways, and I talk about them in my written remarks of examples--It doesn't necessarily favor the--one standard or the other does not necessarily favor the merging firms. In some cases, the consumer welfare standard is more generous; in other cases, it's the aggregate welfare standard.

But the possibilities for conflict are largely hypothetical, because, at least in my experience, agency investigations rarely turn on the welfare standard.

But if the issue does come up, I think the courts should generally--and the agencies as well--should generally prefer consumer welfare, even if the ultimate goal of antitrust enforcement is maximizing aggregate welfare. From the perspective of the

aggregate welfare standard, applying a consumer welfare standard proposes little risk of deterring, systematically deterring, procompetitive mergers, and it increases the likelihood that the antitrust laws will deter harmful transactions. The risk of deterring beneficial transactions, efficiency-enhancing mergers, is low, in part because of the way antitrust law and antitrust doctrines have changed and the rules about merger analysis, particularly since the 1960s. And, in addition, applying a consumer welfare standard induces firms to propose better mergers, on average, from an aggregate welfare standpoint, given information asymmetries, given that firms know more about likely cost savings than do the enforcers, and given that enforcers have a hard time obtaining information necessary to prove the availability of practical, less restrictive alternatives, while the merging firms can more easily restructure contracts to obtain efficiencies at less threat of harm to competition.

On the other hand, the agencies are more likely to prevent harmful mergers if they employ a consumer welfare standard rather than an aggregate

welfare standard. There are a host of reasons why harmful mergers would fall through the cracks at the agencies, having nothing to do with any lack of skill or concern on the part of enforcers. Certainly, in my experience, the agencies care about efficiencies and pay attention to them, and they care about anticompetitive potential and look for that too.

But one reason that harmful mergers might fall through the cracks is a political economy reason. The merging firms may be more effective than the adversely affected buyers in shaping agency views. When the merging firms are better able to lobby enforcers than are consumers, the consumer welfare standard is essentially a commitment device that helps promote aggregate welfare. And I talk--in my testimony I cite the economics literature that makes some of these points.

The bottom line, I believe, is the agencies and the courts are on average more likely to promote aggregate welfare if they use a consumer welfare standard merger analysis than employing an aggregate welfare test.

I also talk in my testimony, in my last

moment, about the allocation of burdens of proof, production, and persuasion, and in my view there's nothing there to--no reason for legislative intervention or by this Commission, and the courts ought to be allowed to weigh those possibilities themselves.

Thank you.

CHAIRPERSON GARZA: All right. Thank you.

Commissioner Kempf?

COMMISSIONER KEMPF: Thank you, Madam Chair.

The first thing I'd like to do is thank all of you for the time and effort you've put into your submissions and for sharing your afternoon with us. This is a subject I've thought about for a very long time, and in reading your various submissions, I found them not only interesting and informative, but also a lot of fun to read. So thanks.

Let me start with a question to the two agency representatives. In this morning's panel, there was a discussion about how one of the best things on the horizon is the commentary that's being worked on to accompany the Guidelines. And, Mr. Heyer, you conclude that one of the things that the

commentary is going to address is efficiencies, and you say we will provide additional guidance on how to treat efficiencies in merger analysis in the upcoming commentary on the Merger Guidelines. And my question to the two of you today is, can you share with us anything in terms of what your timetable is? When can we expect to see these? Do you have anything on that?

MR. HEYER: Well, briefly--and then Mike will agree with me.

[Laughter.]

MR. HEYER: Initially, I know that when the proposal was made to have this and it started to be undertaken, the hope was that it would be finished by year's end. Now, things have a way of slipping sometimes. It may take a bit longer than that. I don't know for certain--I don't think anyone in either agency knows for certain just when they'll be finalized.

My very strong impression from working on it and speaking with the people who have been in charge of it is that they are very seriously committed to, if not meeting that deadline, coming very close to

it. This is, in my understanding, the way things are working; this is not going to be something that was announced as a major project set to be released pretty soon and then drag on for months and years.

COMMISSIONER KEMPF: Mr. Salinger, do you have anything?

MR. SALINGER: I agree with everything Ken said, and he said it better than I would have.

COMMISSIONER KEMPF: Okay. My next question is, will the real Guidelines please stand up?

[Laughter.]

COMMISSIONER KEMPF: And let me explain what I mean by that. There are various interpretations of what the Guidelines mean and should mean in terms of efficiencies, and Mr. Cary, for example, said, you know, there are two things that he thinks important that are required: one is the pass-on and, second, the specificity--easy for me to say--the specificity requirement. And I was reading, in connection with our hearings today, a couple things by a former Chairman of the Commission, Mr. Muris, and he's talking about the 1997 Guidelines. And the question I'm going to ask is, were there two sets of these

things issues? Did I just miss one of them? Because he says he thought that the 1997 revisions made a number of useful changes.

For example, "The revision rejected any requirement that efficiencies be unique to the specific transaction at issue."

He also states that another beneficial change in the 1997 revised Merger Guidelines is the rejection of a merger requirement that cost savings be passed on to consumers.

Now, was he just having a bad hair day when he wrote this article? Or did he miss something? Perhaps I should start with the enforcers.

MR. HEYER: Well, I have no idea what he was thinking when he wrote what he wrote.

[Laughter.]

MR. HEYER: But, that having been said, if you read the section, it's not a very long section, talking about efficiencies in the revised version. As I read it, and as I interpret the way the agency has been applying it, it does say that there are circumstances in which the agency will consider benefits that do not result in short-term price

increases to consumers. I think it's in a footnote. And that may be what Mr. Muris is thinking of.

As far as the other element about merger specificity, again, I'm not certain what he may have had in mind. I can tell you that in terms of how this agency applies things, they do require that there be merger specificity, in the exact sense that Mr. Cary mentioned a short time ago. If it seems pretty clear that those benefits are going to be realized even without the merger, there's the serious issue of why one should be taking a pass on competitive concerns that may exist because there isn't really any trade-off there.

COMMISSIONER KEMPF: Do you have anything to add, Mr. Salinger?

MR. SALINGER: Well, on the pass-through, we make a distinction between fixed-cost savings and marginal-cost savings, because we operate under a consumer welfare standard. So we do think there has to be pass-through. In terms of being able to measure it very precisely, that's a hard thing to do.

On the specificity, again, I don't know what he had in mind. Obviously, the merger--if you have

efficiencies that could be accomplished without any merger at all, that doesn't get credited. But where specificity--it's hard for me, too.

COMMISSIONER KEMPF: You were listening to me.

[Laughter.]

MR. SALINGER: It can also come up as you have a merger--a proposed merger, and then, you know, sometimes there's some other party that might merge--might acquire the target, and there's some discussion as to whether that would be better. And I don't think the efficiencies have--they don't have to be specific to that particular merger for them to be credited.

COMMISSIONER KEMPF: Let me shift to some--and, Mr. Rule, I take it you disagree with everything the two of them just said, just about, but I'll come back to you a little bit later on.

I want to get into some of these issues a little bit. But as a practical matter, I would ask Mr. Rule and Mr. Cary--to me it's inconceivable that any practitioner is going to come in and say, "We're going to have a lot of efficiencies here, but not a

dime goes to the consumer, they're all going into our pocket." I just think in the real world, given, at best, a dispute as to what the Guidelines say, and some reading the way Mr. Cary did, and some courts reading them that way, or reading the requirement that way, that the practitioner is going to come in and not only tout efficiencies, but at least some pass-through to consumers, both because I think that's what the real world would lead to and because I think it's in our interest in securing approval.

So I'm not sure that this isn't a little bit of a Thomistic discussion that is inapt to occur in the real world. To say it differently, George, I'm not sure there will ever be the case that you're waiting for the courts to resolve, because I'm not sure it will ever come up that cleanly.

But let's put aside the issue of whether in the real world this is ever going to come up and discuss it for a minute just in terms of how it should be done in the event it's an issue. And let me start, George, with something I asked you about before we began.

You both, early in your papers, say the

agencies should look at this not as a two-step process where you first decide whether the transaction is illegal, and then in step two you say, "Notwithstanding it's saved by efficiencies," but rather, as an integrated one-step process. And later in the paper you say that that is indeed the way the courts appear to be doing it. But, as I mentioned to you before we began this afternoon, in your paper I take it, at pages six and 11, you seem to be doing the opposite of that. You talk, at page 11 for example, given the magnitude--on the third line from the top: "Given the magnitude of potential consumer benefits, agencies should be receptive to arguments that the potential to bring such innovations to the market faster and more cheaply would justify an otherwise anticompetitive merger." It sounds like a two-step analysis rather than a one-step analysis you both advocate and say is being done. And the same is true in a different context on page six.

Could you comment on that?

MR. CARY: Yes. I do believe it's a one-step analysis, using the terminology that you've employed. The ultimate question is, is the merger

going to be good or bad for consumers? I think that's a simple and straightforward formulation of what merger review ought to be about. And to the extent that the way I framed it on those pages led you to conclude that I meant the contrary, I will clarify that.

Having said that, though, I think as a matter of how the test is actually applied, there is a sequencing of the analysis, and the sequencing of the analysis asks first, assuming there are no efficiencies, does this merger create the potential for an increase in market power? So you would ask that question, does it create the potential for increased market power? And will that market power likely lead to an increase in prices? In other words, how does the merger affect the demand curve? And then you'll ask the question, will the efficiencies that potentially arise from this deal so affect the supply curve that when you combine supply and demand to figure out where prices are, prices go down? That is the analysis.

When you're talking about R&D efficiencies, which is what I believe I was talking about in the

pages you cite--

COMMISSIONER KEMPF: Page 11.

MR. CARY: Right. It requires a much more difficult trade-off because the R&D efficiencies have a longer time horizon and do not necessarily immediately affect quality-adjusted prices. And I will concede that the introduction of those kinds of efficiencies into this framework makes the analysis much more complicated, and maybe you do have to resort a little bit more to the two-step analysis that in general I think ought not to be the way it's done, because you're measuring apples and oranges in that context. But as a general proposition, the question is, will those efficiencies on the R&D side present consumers with better products, better innovation, cheaper products within a reasonable period of time so as to offset the price impact that otherwise would result from the creation of market power?

COMMISSIONER KEMPF: Let me ask you a question following up on R&D for just a moment. We've had a number of panelists, including again this morning, who've discussed the concept of innovation

markets, and some people have said, no, those are important; some have said, no, those are part and parcel of another market, and they're no separate thing; and others have said it's complete hogwash.

Your paper raises this but doesn't address it. Do you have any comments on that?

MR. CARY: I think there are such things as innovation markets. I think they're increasingly important in our economy, and when there are very, very specialized assets, very rare cases where the number of firms with those specialized assets that can make the breakthrough innovations is limited, there is reason to analyze the impact on competition of a merger between those firms within an innovation market context, yes. But that doesn't mean that you would ignore the countervailing efficiencies that might also result from putting those assets together. It becomes a complicated fact-specific question, whether there are real efficiencies that will drive innovation faster, or whether the elimination of competition will retard innovation.

COMMISSIONER KEMPF: Let me turn to a subset of this pass-on question, and that is, pass on how

much? And, Professor Baker, you talked a fair amount about pass-through in connection with the total welfare/consumer welfare discussion. And my question is this: Suppose someone came in and said, you know, "We're going to pass on 90 percent of them and keep the rest and do good things that we haven't decided yet what they are." Where does that come out? Is that passed on or not passed on? Let me state it differently. It is clearly partially passed on, but what are the implications for a merger? Does that meet the test they have to be passed on? Or does it fail the test?

MR. BAKER: So we're putting aside for the purpose of this question whether we really believe the number. Let's assume we believe the number that--

COMMISSIONER KEMPF: Yes. I'm going to ask a series of hypotheticals.

MR. BAKER: All right. The issue isn't what percentage you pass on, whether it's a full pass-on or not. The issue is--if the concern is that the price would go up, the issue is looking at the potential harm to competition and the fact that there are these cost savings, 90 percent of which will be

passed on, what's the net effect? Is the price going up or down?

If there's some other dimension of competition that's being harmed, not price, we would have a related but not identical analysis. So you need to know--you need to think about how much will be passed through in order to net it all out in the hard problem that you're posing, which is the hard problem of George's--

COMMISSIONER KEMPF: Well, let me restate your position and then pose a question to somebody else. I take it what you're saying is, if the amount of the pass-on nets beneficially the consumer in the sense that post-transaction, prices will go down, that is sufficient. Is that a correct articulation?

MR. BAKER: Yes, we have a host of related--

COMMISSIONER KEMPF: Okay. Now that we have--

MR. BAKER: --assumptions we're making.

COMMISSIONER KEMPF: Let me shift it to Mr. Cary. Suppose they do that math and they say, you know, "This is really efficient, and we can lower prices; here's what we're going to do. We're going

to keep 95 percent and only pass on five percent, but it will"--and everybody stipulates; we don't have any factual disputes here. "Prices will go down even if we keep 95 percent of it." I assume that then that's hunky-dory.

MR. CARY: Defendant wins, right.

COMMISSIONER KEMPF: Okay. So the pass-through is only that portion, however minuscule, necessary to result in a net price decrease.

MR. CARY: Yes, and that's why I completely agree with Professor Baker's view that the number of cases that are going to fall outside this test that satisfy Mr. Rule's total welfare test is going to be really small.

COMMISSIONER KEMPF: Well, I think it's going to be small for that and another reason, which is that nobody's going to make the arguments.

Now, let me refine that one step more. Suppose the people come in and say, "You know what? We aren't going to pass a nickel of this on to consumers, but we're going to benefit them better because not only will our volume increase, but if we take the savings and use it to build a new plant, the

new plant can result in even lower prices than putting all this throughput through the old plant. So if we look at it long term, Mr. Enforcer, prices will go down, but they won't go down from any direct pass-through, but by the fruits of reinvestment in capital that will result in the lowest possible price."

MR. CARY: First of all, to be really clear, when you say that they come in and say, "We will not pass it on, or we will pass on 95 percent," I'm assuming you're using that as a shorthand for the proposition that the economic analysis means or leads to the conclusion given the competitive conditions in the market that this is the amount that market forces would force to be passed on. I don't view this as a subjective test at all. I view it as an objective economic test. So--

COMMISSIONER KEMPF: What I'm doing is I'm sort of giving these as stipulated facts.

MR. CARY: Right. Okay. So if the stipulated fact is that they will not pass on any, you do get first to the question of verifiability of--

COMMISSIONER KEMPF: On all these I'm assuming cognizable benefits.

MR. CARY: Okay. So we're assuming that there will, in fact, be fixed costs sometime in the future.

COMMISSIONER KEMPF: There will be increased fixed costs. The new plant will cost more than they can sell the real estate and the old plant for. But the result will be dramatically lowered marginal costs of production.

MR. CARY: I think if that's demonstrated and if it's demonstrated within a reasonable period of time and those reductions in marginal costs, present-valued, are greater than the price increases that otherwise might occur, applying the same analysis, yes, I think you'd clear that deal, again accepting as part of your hypothetical that all other elements of the Guidelines including verifiability and merger specificity are satisfied.

COMMISSIONER KEMPF: Okay.

Professor Baker, let me go back to you for a second. In discussing the total versus consumer welfare stuff, you seemed to suggest to me that doing

the consumer one is easier, whereas the total one is harder. Perhaps I'm misreading you. The reason I ask that is, it struck me that if you didn't have to worry about how it's doled out, as it were, total would always be easier to figure out.

MR. BAKER: No, I don't know about that; I think they're both hard.

COMMISSIONER KEMPF: But as between them, isn't it harder to figure out when you have to allocate a pie than it is to do it--

MR. BAKER: It's a slightly different question. You're looking at--you have to analyze--in theory, in principle, you have to understand what happens to price and output in order to answer both questions. You have to understand the magnitude of--you have to know things about the marginal benefits and costs in order to assess welfare regions, to assess total welfare--I mean, they're all--they both raise problems. They're both complicated. I'm not sure that one is easier than the other.

COMMISSIONER KEMPF: Okay. If I look at some of the submissions we've had, not necessarily from the panel, but historical submissions, there

seems to be a trend line that efficiencies were a bad thing used to condemn a merger, to cases that said we're not going to condemn a merger just because it creates efficiency--in other words, a position of neutrality; to, well, it's a good thing maybe at the margin, to, no, it's a really good thing; to, finally, some of the pieces advocated, that in a close call, since both efficiencies and competitive harm are hard to predict, you should go with the efficiencies, not the competitive harm, because the risk of losing the benefits exceeds the risk of the other one, of the competitive harms.

I am going to direct this to Mr. Rule. Does that appear to be the trend? And if so, is that a good thing?

MR. RULE: Well, I think that the time when the Supreme Court said efficiencies were not only not to be considered, but they were a bad thing, I think I characterized it as the nadir of--

COMMISSIONER KEMPF: Your *Clorox* quote.

MR. RULE: Yes. So I would say it's a good trend to have moved away from there, because I think it reflects the general fact that, for antitrust law,

the courts have recognized that it is a statute about some kind of surplus, whether it's total surplus or it's consumer surplus. I think that's an important recognition.

You know, I guess the point I'm trying to get across--let me answer it by answering the last question you posed. It's not so much that a total welfare, or really, what I think, by quoting Bob Bork, the Supreme Court means by consumer welfare is easier. It's just that it's important to understand what the objective of your rules is when you are constructing those rules. And the fact is that what has happened, I think, as a result of, to some extent, moving along, accepting efficiencies more, not really understanding why they were incorporated the way they were at the beginning, we have come to a point where the issue now is whether a merger is likely to increase price at all. And, in a way, I think that's a bad thing, because I think what it means is that certain mergers that pretty clearly might be seen to increase overall surplus, therefore, society's wealth, are essentially condemned. And I think that's a bad thing.

So, in a way, in kind of an odd way, as we've moved further and further in terms of accepting efficiency, we've done so at the cost of potentially prohibiting certain mergers that could benefit efficiency, both because it has meant that people believe that the important thing is price effects; the second because believing that parties can always come forward and prove efficiencies, we're willing to condemn mergers with even slighter price effects; and then, third, a limitation on the efficiencies that we actually consider. And all those things I think add up to being a bad thing, so there's a trend that's positive in the sense of recognizing efficiencies. But I think the trend's overall impact on antitrust enforcement has probably, on balance, been negative. But there have obviously been a lot of other things happening at the same time.

COMMISSIONER KEMPF: I have a couple more. Maybe I'll have some time at the end.

CHAIRPERSON GARZA: Okay. That's fine.

Commissioner Valentine?

COMMISSIONER VALENTINE: Okay. First of all, thanks, all, for being here this afternoon.

I've only got five minutes. I'm going to be much more modest and try not to get into Talmudic debates here.

George, you did note that the Guidelines are relatively sparse in addressing R&D efficiencies, and several of the other witnesses that we've had on various panels have made similar comments. And I have to confess that I believe when we were writing the Guidelines and ended up saying simply, you know, those relating to R&D are potentially substantial, but generally less susceptible to verification and may be the result of anticompetitive output reductions, you know, we were punting a lot. We could have said a lot more, and yet we were worried about eliminating two different productive research tracks, things like that.

I'd like to ask each of the panelists, if you were actually trying to craft language or possibly even language like commentary on the Guidelines that the agencies are doing now, what might one say in addition, with respect to R&D efficiencies, that would be helpful both to agencies in terms of analyzing them and to counsel and

companies in terms of thinking about whether they've got efficiencies that they can present to the agency?

And then to agency folks, if you want to add any thinking that the agencies may be doing in this respect, either in conjunction with the commentary on the Guidelines, feel free to do so.

Jonathan, do you mind if I start down at your end, which will sort of allow the agency folks to finish up a little more toward the end?

MR. BAKER: I mean, I agree with you that R&D efficiencies are important, and I agree that the Guidelines don't say very much about it, but I really don't know what to add. I think we need more experience in cases of the agencies and have them codify that. I really don't have a suggestion.

COMMISSIONER VALENTINE: Okay. George?

MR. CARY: I will echo Professor Baker's comment. I don't have a specific suggestion either, as I mentioned in my written piece. I think, though, that the state of the art on R&D efficiencies has moved quite a bit from the time that we were drafting the Guidelines.

If you look at the consolidation in

pharmaceuticals in particular, and the way that management, senior management of pharmaceutical companies is grappling with this question of how to organize R&D, how to use resources, what kind of managerial units are most effective in generating new drugs, new chemical entities, I think there's a lot of learning to be had, and that's why I recommend that the Federal Trade Commission and the Department of Justice reconvene their hearing processes and bring the executives that are managing those processes before them and ask those kinds of questions.

There's a lot more to know than I think I'm in a position to say today or that we knew at the time that we prepared those Guidelines, and I think the Guidelines could be modified to reflect that learning.

COMMISSIONER VALENTINE: But it's not because R&D efficiencies raise--and, again, I don't want to get back to the big picture stuff terribly in terms of consumer versus total welfare, but in a way because they are less likely to result in any results tomorrow that are measurable for consumers. I assume

that's part of the problem.

MR. CARY: Yes, I agree that that is part of the problem. I think that the consumer welfare standard is the appropriate one for judging R&D efficiencies as well as other efficiencies. But I think I'm gaining confidence from the way that the Guidelines have been applied in other markets over the last eight years, that, in fact, this is not a problem that's insurmountable and that with greater study there is a way that we can suggest how to take into account these efficiencies in more detail than we have done so far.

COMMISSIONER VALENTINE: Okay. Ken?

MR. HEYER: Well, there aren't that many words in the Guidelines talking about R&D efficiencies, and there is, I think, a good reason for that. I think the framework of the Guidelines more or less tells people how efficiencies are going to be evaluated. I think perhaps, sad to say, you have-- you know, you have the merger specificity requirement, you have the demonstrating magnitudes requirement, right? Most mergers, perhaps even more so ones involving innovation claims and R&D, tend to

be very fact-specific, very idiosyncratic. Coming up with specific rules or proxies that would be clearly applicable to R&D but not to other types of mergers, or vice versa, I think might be stretching the limits of our knowledge, and the alternative being to use the basic principles in the Guidelines and recognize that when innovation claims come in from mergers, they're going to be treated on a case-by-case basis, and facts rather than mere assertions and allegations are going to be the determining factor, is probably the best that can be done.

COMMISSIONER VALENTINE: I can actually think of one merger that was not unlike *Genzyme* and *Novazyme* that Mr. Rule brought to us, and he convinced us of--that's never been public, I think, either, has it? Did that ever--

MR. HEYER: Now is the time, Rick.

[Laughter.]

COMMISSIONER VALENTINE: In any case, any comments, Rick?

MR. RULE: The only point I would make is I do think it's a very good question, but the way in which--the reason that the question comes up is a

reflection of the fact of the weaknesses of what I'll call a price effects or a consumer surplus approach. I think the fact that you want to recognize there's sort of a notion inherently that you really do need to recognize R&D efficiencies to me is a recognition that consumer welfare as I mean it or total surplus is really more important, because you want to--you know, to the extent that producers can get together and produce things using fewer resources or come up with new ideas, you don't want to discourage that.

And I think part of the difficulty in applying the Merger Guidelines to R&D is that they're a bit schizophrenic. It's hard to do it within the framework of price effects, which, again, is one of the reasons, I think, that you ought to go back to what the term meant in the analysis was back in the '80s and sort of think it through.

The other point, though, I would make--and I think Ken and others have talked about this--I'm not sure more words is a good idea. I think that to some extent it is a little bit I'll know it when I see it, and you need to be flexible to incorporate a lot of different possibilities.

The one that always strikes me as pretty significant in R&Ds, though, is that, typically, you are showing complementary strengths of the parties in terms of developing certain kinds of technologies and the parties being able to articulate a story as to why putting those two complementary strengths together is likely to generate some result that otherwise wouldn't be possible if each party acted independently.

That's generally true for a lot of efficiencies, but I think it's also true for R&D.

COMMISSIONER VALENTINE: Michael?

MR. SALINGER: Well, you said *Genzyme/Novazyme*; that's the one example I know of where the Commission has cited efficiencies of any sort explicitly as a reason why they weren't going to challenge a merger. So I think we're able to take account of efficiencies in R&D.

COMMISSIONER VALENTINE: And that maybe one should write about them in statements rather than in guidelines. Is that the other conclusion?

[Laughter.]

COMMISSIONER VALENTINE: All right. That's

enough. I've had enough time. Apologies.

CHAIRPERSON GARZA: Commissioner Warden?

COMMISSIONER WARDEN: I was pleased to hear Mr. Salinger say that efficiencies that a board found adequate to justify the investment in an acquisition were entitled to credibility. In the merger review, I think that's entirely sensible.

We have had, however, here suggestions by Mr. Scheffman this morning in his written statement, by Rick Rule in his oral statement today, and to some extent perhaps by Mr. Cary in his written statement with respect to R&D efficiencies, that the agencies impose too high a standard in actually accepting claims of efficiency.

Now, I agree with Mr. Heyer that, you know, pie-in-the-sky talk is cheap, and that doesn't go anywhere. But--and we had a witness earlier who had been involved in a biotech merger as an executive of the acquiring company that was turned down that looked like it offered at least a material advantage in terms of the D part of R&D in that it would get a drug to market faster. I don't know how you calculate the consumer welfare or quantify the

consumer welfare benefit from that, but it's got to be something. And he said to us that his impression was that, in that one matter at least, the enforcement authority resolved all doubts against claims of procompetitive effects and all doubts in favor of clams or possibilities of anticompetitive effects.

Now, I think that's inconsistent with the approach Mr. Salinger indicated the Commission was taking today. I'd like to know if it's also inconsistent with the position that the Antitrust Division is taking. And if it isn't inconsistent, shouldn't it be, Mr. Heyer?

MR. HEYER: I think it would be a gross falsehood to say that the Antitrust Division resolves all doubts in favor of likely harm.

COMMISSIONER WARDEN: How about against likely benefit?

MR. HEYER: I think we look at claims of benefits on their merits, given the facts, and we look at claims of harm on the merits given the facts. And I don't think we kind of meet in a separate room and say, "Well, we know there's going to be harm, and

we're not even going to pay much attention to the benefits." That's not the way we do things.

COMMISSIONER WARDEN: I take it you concur in those observations, Mr. Salinger?

MR. SALINGER: Well, we take benefits very seriously.

COMMISSIONER WARDEN: And you don't resolve doubts against benefits and in favor of harms.

MR. SALINGER: No.

COMMISSIONER WARDEN: Mr. Cary, in your answer to Commissioner Kempf's question about the new plant, you indicated that could be taken into account. My question is, is that a merger-specific efficiency given that, if the new plant is a decent investment, the capital markets will supply the company with the capital needed to make that investment?

MR. CARY: I can imagine that in most cases it likely would not be merger-specific, yes. Commissioner Kempf, however, asked me to assume that the efficiency was cognizable under the Guidelines, which I took to include an assumption of merger specificity.

COMMISSIONER WARDEN: Thank you.

We had one real suggestion for improvement in the merger review process this morning from Bobby Willig, which was greater transparency to the merging parties with respect to the agency's final economic analysis, which he thinks is being deterred by concerns over confidentiality of other market participants' data. And it seems to me that greater transparency is desirable and could be achieved under some kind of protective order, like the courts use, while maintaining confidentiality. And my question to the two enforcement agency representatives is, do you believe that can be done under existing statutes, that is, the use of protective orders to enable greater transparency? Mr. Salinger?

MR. SALINGER: Well, I don't know about the use of protective orders, that's a legal issue, and I'm not qualified to answer that. I do think that when we have concerns, I think we make it clear to parties what our concerns are, and we try to have a candid exchange with the parties about them because if we can find a way to resolve them, we're happy to do that.

MR. HEYER: I'm not a lawyer, so hopefully I haven't been breaking the law here inadvertently, but we have done the sort of thing that Bobby is suggesting. I can think of several cases where we've literally gone back and forth with the parties--Dennis may even know of some--where we've maybe not given them data that was confidential and said, "Please forget this as soon as you see it," but we've done things close to that, such as, "You've got certain data," or, "We'll give you aggregated data;" could you try it, tweaking certain assumptions in the model, to see what comes out? They've said the same thing to us.

In fact, there wouldn't be a confidentiality problem when, let's say, the parties on the outside were to say we think if you were to run the model a certain way or change certain assumptions--you don't have to give us the data, just make these changes, see what comes out. That doesn't create confidentiality problems. We do that sort of thing.

COMMISSIONER WARDEN: Thank you.

MR. RULE: Could I just add one thing for the record and for whatever it's worth? I hope that

what was just said is accurate. I will say that, not too long ago but under a different administration, I was involved in a deal where, as is typical, the parties were showing the agency--it happened to be the Department--all of their data and models. And the response was, "Well, we're getting different results."

The response to our request to see what the economists at the Division were doing was not, "Gee, it's confidential, and we can't get around that problem;" it was, "Well, if you'll agree not to litigate, we'll let you see our--but if we're going to have to litigate with you, we don't want to disclose our models in advance." And for various reasons we decided to decline the offer.

So I'm not sure that confidentiality is the only reason they're not as forthcoming as they should be, or at least in the past. Perhaps we're past that day.

MR. HEYER: Well, I mean, the only thing I'd add to that, again, not being an attorney and not being a final decision-maker within the Division, and not being as familiar as to the back-and-forth of

litigation strategy and litigation prep--I guess I can imagine circumstances where one side or the other might be a bit wary about revealing too much to the other side. The "too much" might be something people could disagree on. But I would say that in terms of your basic question, matters I've been involved in, including some with Bobby Willig, we've done a fair job of keeping each other informed of what we're finding and why.

COMMISSIONER WARDEN: Thank you.

CHAIRPERSON GARZA: Commissioner Jacobson?

COMMISSIONER JACOBSON: Thank you.

Just one observation that I can't resist, which is that *Reiter v. Sonotone* held, at least as I recall it, that an individual consumer could sue to recover damages from the wealth transfer resulting from a resale price maintenance violation. So I think it's somewhat extravagant to say that, by quoting three words from Judge Bork's book, in the same unanimous opinion that the Court was rejecting a consumer welfare standard, as we call it today, in favor of total welfare, but that's just my point of view.

MR. RULE: Can I respond?

COMMISSIONER JACOBSON: You can respond, but do so in the context of answering this next question, which is also directed at you.

MR. RULE: Okay.

[Laughter.]

COMMISSIONER JACOBSON: That is the following: Do you believe that a merger that lowers price modestly to customers, both long and short term, but imposes losses on competitors that easily exceed the consumer gain should be prohibited?

MR. RULE: Well, let me start by responding to your premise, and then respond to that point, which is also addressed in my statement.

Reiter v. Sonotone, it is true, involved the question of whether or not consumers were entitled to recover the difference between the price they paid and what the competitive price was in the context of a price-fixing agreement. Okay? So in the context of a price-fixing agreement, there is not the issue of producer surplus. There is not the--or, I should say, productive efficiencies. The issue there is purely one of allocative inefficiency, because you

have a number of competitors getting together to raise price.

So you really can't, based on the facts of *Reiter v. Sonotone*, reach a conclusion, in my opinion, that supports a consumer surplus standard, because whether it's consumer surplus or consumer welfare, as I say, you would have reached the same conclusion.

As I point out and as, you know, most advocates of the position that I articulate have stated, under a consumer welfare--read broadly--or total welfare standard, where there is, in fact, a violation of the antitrust laws, which by definition means that the allocative--you know, in my view, the allocative inefficiency outweighs the productive efficiency, you have to tax the surplus that the producers get from consumers, or you don't deter the conduct. That's the reason you do it.

So I don't think *Reiter v. Sonotone*, in fact, is--

COMMISSIONER JACOBSON: I'm going to interrupt a bit. *Reiter v. Sonotone* involved price fixing, but the price fixing included vertical price

fixing. Probably, to me at least, the most memorable paragraph of "The Antitrust Paradox" is the one that says that a single paragraph in Justice Hughes' decision in *Dr. Miles* was the single greatest misstep in the history of antitrust law.

So to say in a vertical price-fixing case that, you know, there were--which involved consumer welfare, that the court would quote words of a consumer welfare standard, to extrapolate from that that they were buying into the entire regime of *The Antitrust Paradox* I think is, as I said, somewhat extravagant.

MR. RULE: Except that they are quoting Judge Bork, and if you go back and look at what Judge Bork says, how he defines "consumer welfare prescription"--

COMMISSIONER JACOBSON: Okay.

MR. RULE: That's all I can say. That's what they quote.

COMMISSIONER JACOBSON: All right. Let's get back to--

MR. RULE: No, going to your question, as I said, the point of understanding what the purpose of

antitrust is is to understand how you develop rules. But as I, you know, allude to in this paper but discussed at some length the last time I appeared before the Commission, it is equally important to a consumer welfare standard to ensure that your rules are efficient, that your rules serve the ends of consumer welfare. It is a very bad idea to have courts trying to second-guess decisions on efficiencies by competitors or arbitrate, you know, fights between competitors about who's going to get what amount of surplus.

Courts aren't very good at that. There's no real standard for doing it. And ultimately, at the end of the day, surplus is surplus, and it's--and everybody benefits.

The question is, what is the total amount of surplus that is out there in ways that we can measure? And while we have a decent theory for coming up with a measurement of allocative inefficiency, and we can to some extent understand, because the parties do, what they expect in terms of generating their own efficiencies, would be very difficult and I don't think worth the candle for, you

know, courts to go off and try to understand the relative effects on different people's efficiencies. And the example that I think your question is drawn from and in Steve Salop's piece strikes me as--I mean, there are a lot of flaws, or at least it's a very unlikely scenario to come about. So I'm not sure that, even if I agreed with the premise that you'd want to develop a rule based on a highly hypothetical scenario that I don't think could ever be detected, that may never occur.

COMMISSIONER JACOBSON: Just one quick follow-up. It's not hypothetical that a total welfare standard, strictly applied, includes the welfare of competitors.

MR. RULE: It includes the surplus. It includes total surplus. That is true. But a situation that he hypothesizes where there's going to actually be a relative increase in cost as a result of a decrease in price, it strikes me, is very unlikely to occur.

COMMISSIONER JACOBSON: We'll reschedule this debate to another date. Thank you very much, Mr. Rule.

CHAIRPERSON GARZA: Commissioner Carlton?

COMMISSIONER CARLTON: Thank you.

George, I want to make sure I understood something you said in your statement. On page six of your statement, you say that the Supreme Court pointed out that each consumer has a property right in not being overcharged in its own transaction.

MR. CARY: Right.

COMMISSIONER CARLTON: And what bothers me about that, if I take that literally as an economist, is that it means I have to--if there's a merger case, and suppose as a result of the merger they're going to make a product more efficient and that's going to benefit 99 percent of the consumers, but there's one percent of us who just don't want that product changed--

MR. CARY: Right.

COMMISSIONER CARLTON: I mean, if I took that sentence literally, that would mean, you know, if I was one of them who liked the old product, I could stop the merger. That can't possibly be right. It must be when you're talking about a consumer standard that you're aggregating across consumers in

some sense. Is that a fair--

MR. CARY: Yes, that is a fair observation. I think what we're talking about is in the context of a relevant product market, we're talking about aggregating the consumers within that market. The point is, though, that the antitrust law is not indifferent as to whether consumers are being hurt for the benefit of producers. That was the fundamental point there.

COMMISSIONER CARLTON: That just raises the question--we know there are different groups of consumers, and there's a producer. So we can identify those as different agents. And, therefore, I think what you've said is you'd aggregate over consumers. So let me ask Jon a question then. I think you're agreeing with that in your paper. And when you're focusing on consumer surplus as the standard rather than total surplus, I guess I have two questions. The total surplus standard from an economic point of view is the natural standard you use whenever you do cost/benefit analysis, project analysis. And they do that throughout the government when they decide whether to build a road, whether to

do--you know, it's pretty standard. The World Bank does it when it's talking about whether to build a dam. And I'm not--it just strikes me as odd that we're going to say that we should use a different standard for antitrust. Putting aside legislative history, it just seems like we're going against what the profession does in most other cases.

Can you comment on that?

MR. BAKER: Well, we all know that the partial equilibrium framework is really an approximation, that if we wrote down in--if economists write down a social welfare function, you have the consumption paths of all the different consumers, and you have to somehow weight them and aggregate them up, and we have all gotten into the habit, I suppose you'd say, of looking at antitrust problems from the point of view of the industry and using the device of the partial equilibrium framework, which aggregates the consumers within the industry and the producers within the industry and the like.

The reasons for adopting--there are a number of reasons for focusing only on consumer surplus that

commentators have advanced, and some of them are the kind of fairness and entitlement ones that you're talking about. There is probably--there's a political economy reason having to do with the idea that we want to not take advantage of some group of people, like consumers, to such a great extent across the economy that they'll give up on the antitrust laws and say, "These antitrust laws are nothing; all we end up with is we lose our jobs and get higher prices besides. Let's have price regulation."

But then there are also reasons that--economic reasons for a consumer surplus standard that I talked about in my paper that say if you use the consumer surplus standard to address information asymmetries or bargaining problems and the like, and that systematically using the consumer surplus standard will promote aggregate welfare, which is what I was emphasizing--which is what I'd emphasize in a conversation among us economists.

COMMISSIONER CARLTON: Yes. Well, let me just turn to a slightly different question, and that is, if you distinguish between producer groups and consumer groups--consumers on the one hand, producers

on the other hand--how in the world can you attack monopsony? Because it seems to me you would be in favor of consumer buying groups who exploit sellers. And there's this basic problem, it seems to me with the position. Can you reconcile that?

MR. BAKER: Well, I have two classes of answers for you. One is that the--if we're talking about intermediate goods--

COMMISSIONER CARLTON: Just a cartel of consumers, final consumers, who are going to take advantage--they're going to monopsonize an industry composed of producers. Monopsony, reduce output, their price goes down, they're delighted, their consumer surplus goes up, the economy is much worse off, and total surplus goes down. It seems like that you would rule that out if I took your standard.

MR. BAKER: Well, if you actually read my standard carefully, you know, I describe it as--let's not be doctrinaire about it. If there's some giant, you know, aggregate efficiency gain and a small harm to consumers, or *vice versa*, I would--but putting that aside, if you systematically had an economy that permitted what you described--

COMMISSIONER CARLTON: You mean it's consumer surplus unless it matters, and then it's total surplus?

MR. BAKER: No, no, no. But if it's very large and you--

COMMISSIONER CARLTON: Why don't you stay with the monopsony--

MR. BAKER: Okay, let's go back to monopsony, you have the same political economy issue as we just talked about in reverse. If you systematically allowed in the economy consumers to get together to exercise monopsony power, you'd lose the producer commitment to having antitrust laws, and you'd say we'd be better off going to Congress and getting freedom from the antitrust laws for everybody altogether so we can collude and respond.

You have the same problem looking at the big picture in reverse.

COMMISSIONER CARLTON: So you would abandon the consumer surplus standard in that case?

MR. BAKER: Sorry?

COMMISSIONER CARLTON: You would abandon consumer surplus when applied to monopsony?

MR. BAKER: Systematic monopsony of consumer--I'm sorry. Monopsony power--a cartel by consumers, I would attack that if I were the--

COMMISSIONER CARLTON: Even though it's inconsistent with the standard of maximizing consumer surplus. Okay. My time is--

MR. BAKER: I think in the long--it's consistent with protecting the antitrust laws, which would then maximize consumer surplus.

CHAIRPERSON GARZA: Thank you. I'm going to maybe pursue the tack that Dennis was taking for a minute.

In reading Mr. Cary's testimony, I got the impression that what you were saying was that the consumer surplus standard appears to be based on the notion that the antitrust laws are concerned about distribution of wealth. Yet--

MR. CARY: In part.

CHAIRPERSON GARZA: In part, but yet, isn't it the case, as described by Mr. Rule in his testimony, that the unfettered market allocates scarce resources on a total welfare-maximizing basis? And if that's the case, then what would be the basis

for using antitrust merger enforcement not to ensure the maximization of total welfare by making sure that the marketplace operates in an unfettered fashion, but to maximize consumer surplus?

And then taking to heart what Debra has suggested, which is, let's bring this down to the practical, I tried to think of what the practical consequences would be of choosing the consumer surplus standard, and one is the one that Dennis raised, what you do with monopsony? Another is one that Jonathan started to raise, I think, which is, what do you do then when you have a case involving intermediate products? Does it matter then if you apply a consumer surplus standard? Do you require that the direct purchaser pass on savings to the ultimate consumer? What do you do if you've got two different markets, and consumers in one market are going to be benefited by productive efficiencies; consumers in another are not, but the merger can't go--there's no way to fix the merger through a divestiture or something? Do you then block the entire merger and make a choice, in essence, between two groups of consumers? And how do you do that?

And then I don't know if there are any other sort of more practical consequences that any of the panelists can identify for choosing the consumer surplus standard.

I'll start with Mr. Cary.

MR. CARY: That's a lot of questions, so--

CHAIRPERSON GARZA: Well, if there's any one that's good in there, then you can answer that.

[Laughter.]

MR. CARY: First of all, I think, as we said at the outset, the antitrust laws should not stand in the way of increasing allocative efficiency in the vast majority of cases. The question that we're talking about is that narrow group of cases where consumers will demonstrably be negatively impacted as a result of the creation of market power and where the efficiencies coming from the transaction are sufficiently trivial that they will not reverse that tendency. That's going to be a very narrow range of cases in the first instance, and for all the reasons that I stated previously, and Professor Baker stated, there are lots of good reasons to think that, overall, we would all be better off if that were the

line that were toed.

Second, you do have a regime where, going back to this long history that we talked about of the antitrust laws and merger enforcement in particular, we have gone from *Vons Grocery* to the question of whether two-to-one ought to be permitted because there are significant efficiencies. And in the course of going down that long road, we have virtually imposed on the antitrust agencies a burden of showing that there will, in fact, be price impacts from a merger. The standard of a "substantial probability" that the merger "may tend to reduce competition," that is, the incipiency standard of the statute, is out the window. The agencies, as a practical matter, have to show that some group of consumers is going to see its prices go up.

It seems to me that with the decline of the incipiency standard and with the increased rigor of the requirement put on the agencies to show actual consumer injury, the current showing required is consistent with both the allocative efficiency standard and the consumer standard in the vast majority of cases. The last paragraph of Mr. Rule's

paper would agree with this. It's entirely consistent to say, if you've got a demonstration that market power will be exercised and that consumers will be injured through higher prices, it's incumbent upon the merging parties to demonstrate that, in fact, the efficiencies are of such a magnitude as to counter that tendency.

Given that the parties control access to that information, given that it's not like the other pieces of the anticompetitive effect paradigm, where the agencies can go to third parties and find out about barriers to entry, or to customers and find out what alternatives are available; it doesn't seem to me to be counter to the total welfare of the society to insist that parties demonstrate efficiencies in such a magnitude and with such clarity that, given the government's current standard of showing an actual price impact, that the two forces can be judged in comparison to one another.

The entire framework standard for both the parties and the agencies has shifted to the point where both the parties and the government must show concrete facts in support of their position. The

result will get you as close as one could normally expect to get to a total welfare standard.

I do believe that the antitrust laws have an income distribution component and that exercise of market power so as to deprive consumers of their money is something that is inimical to the antitrust laws. I don't think that in order to vindicate that goal you need to materially reduce the efficiency of the economy.

CHAIRPERSON GARZA: Ken?

MR. HEYER: Can I also pick from among your questions?

CHAIRPERSON GARZA: Sure.

MR. HEYER: I think one of them is answered by something I cheated and I saw Jon scribbling down over there. He wrote down the words "inextricably linked," and where you do have this issue of some consumers potentially benefiting and other ones potentially being harmed, then, as the Guidelines and Jon describe, sometimes you can have your cake and eat it too, if you can do some kind of surgical divestiture that preserves the benefits. But when you have no choice but to either take the whole thing

or abandon the whole thing, I think either--any type of standard would argue in favor of weighing those two things.

CHAIRPERSON GARZA: Mr. Rule?

MR. RULE: The only thing I would say is, I mean, that's what I think the right answer is. It's not obvious to me that--

MR. HEYER: Are you going to give the wrong answer?

MR. RULE: No, it's not obvious to me that, if you believe that the standard is consumer surplus or price effects, and you read the Guidelines, if they were truly being consistent and applied coherently, you'd come to that conclusion, because the fact is there's a price increase, and the benefit is an increase in surplus in another market. And it's not obvious to me, given what the Guidelines--how they're read now, that you really can do that trade-off. But, you know, it's the right trade-off. It's just that I think if you believe that the standard is consumer surplus and price effects, I don't see how you get there.

CHAIRPERSON GARZA: Anyone else have a

comment before we pass it on?

MR. BAKER: One brief comment, which is, you have the problem of trading off markets regardless of whether the standard is aggregate surplus or is consumer surplus. You still have to decide whether a benefit in this market will outweigh a harm in that one.

MR. RULE: But in one standard, it's relevant; in another it's not.

MR. BAKER: I'm not sure why you say that.

CHAIRPERSON GARZA: Maybe we'll have time to come back to that.

Commissioner Litvack?

COMMISSIONER LITVACK: Thank you, Madam Chairman. You will have time, because I will pass.

[Laughter.]

CHAIRPERSON GARZA: All right. Commissioner Burchfield, did you have any questions?

COMMISSIONER BURCHFIELD: Yes. Following up on the dialogue that just occurred, I find this a very fascinating debate, and I must disclose my bias is in favor of the aggregate surplus, the total surplus approach here. But I wanted to ask Mr. Rule,

how definitive should a merging party have to be before the agency to show where that surplus is going? Is it sufficient, as Commissioner Kempf suggested, that perhaps the merging party could go in to the agency and say, "We're going to merge, we're going to have efficiencies, and, by God, we're going to keep it, nyah, nyah, nyah, nyah?" Is that enough? Or should the merging party say, "We are going to build a plant?"

[Laughter.]

MR. RULE: Well, that's probably not the best way to put it. But, I mean, again, it seems to me that the observation of a total surplus standard is that, you know, it is true that producers may get surplus, which is just money, and then they're going to go use it, probably, as consumers elsewhere. But the reason that you can think of all consumers benefiting, whether it's in that market or it's somewhere else, is that, as a result of the efficiencies, of lowering the cost of production in that market, that means that fewer resources are needed to produce what is being produced. If output doesn't go out, doesn't go up, those resources are

being used somewhere else. And that's where the sort of increase in value and wealth is to the world.

So, just as a theoretical matter, if I can prove to you that costs have gone down in a market, I haven't made those resources disappear. They're going somewhere. So somewhere out there those resources are being employed in a way that's going to benefit the economy, because it's going to mean that output is going to be produced at a lower cost probably somewhere than it otherwise would be. So that's why--

COMMISSIONER BURCHFIELD: The difficult part of the analysis comes in, though, when there's not only a more efficient cost of production, a lower cost of production, but I assume Professor Baker would ask how you respond if there's a lower cost of production and a higher price to the consumers simultaneously.

MR. RULE: And that's why, you know, at the end of the day, notwithstanding the passion with which I feel my argument, I'm not sure it matters a whole lot in terms of the conclusions you come to in terms of the rules, and this has been said by several

people. Because notwithstanding having said all that, it is extremely difficult to calculate with any sort of precision allocative inefficiencies as well as even productive efficiencies. And for that reason, I think--but this is--I mean, my point is, you need to make sure that your standards for determining that a merger actually is going to harm competition or create allocative inefficiencies is pretty rigorous, that, you know, simply because some econometric model shows that there's going to be a half-percent price increase or a percent price increase, that shouldn't mean that you then have to go to the parties and the parties have to show, "Well, I've got enough efficiencies that I can counteract that." There ought to be a standard that's pretty high and that says that, only if there's really a significant impact on allocative efficiency do we even care.

At that point I do think that it's appropriate to allow the parties to come in and say, "But we've got really big efficiencies," and I grant you Commissioner Kempf's point that just, you know, human nature being what it is, judges being what they

are, and, frankly staff attorneys and economists being what they are, you'd better be able to show that that's going to generate benefits to the consumers they're actually looking at. And that's partly why you have this pass-on. It's also because you have to be doing what I call an orders-of-magnitude comparison, that the efficiencies have to be so large that--I think George is right, that in most cases it's going to appear that they will translate into lower prices.

So as a practical matter, I do think there probably has to be a pass-on, but my point is, I wouldn't require that they actually be shown. I'd just require that the magnitude of the efficiencies be very large as compared to what you think the allocative inefficiency is, and that really ought to be a sort of rough justice way of trying to balance these two things.

COMMISSIONER BURCHFIELD: Mr. Salinger?

MR. SALINGER: Well, the typical case, if there are efficiencies, the typical case is going to be that the efficiencies swamp the allocative inefficiency, because, you know, at the risk of

falling into economic-speak--I see Dennis nodding. The efficiency, the marginal cost savings, those are going to be what we call first-order effects, and the allocative inefficiency is going to be a second-order effect.

So if you go to a total welfare standard, that's going to have a huge impact on how we judge cases. And if you'd like to see an example of it, look to our neighbors to the north and their *Superior Propane* case where they have--it's complicated, but as I'm sure you all know, something more like a total welfare standard. And relatively small savings were, you know, much bigger than the dead weight loss, and we should expect that.

MR. HEYER: The only thing I would add is that the--while I wouldn't characterize them as safe harbors, the numerical thresholds that are tossed around in the Merger Guidelines I think properly suggest that there is going to be the sort of rough justice that Rick is talking about. It tends to be only in the cases where we're seriously concerned about market power increases, maybe because of large increases in concentration, that we do start asking

people to demonstrate the efficiencies that they're asserting.

COMMISSIONER BURCHFIELD: Professor Baker, you had something to say.

MR. BAKER: Yes, thank you. Two comments.

One is I think on Michael's point about the allocative efficiency loss being second order, I'm not sure that's right if we start out with price above marginal cost before the--then the allocative efficiency loss could be first order as well, and you actually have a trade-off to make. But I think that he must have been assuming a competitive market before.

On another point, there's a lot of conversation there about cross-market trades, and there are also intertemporal trades. I think Commissioner Kempf started out the same way, with a hypothetical where the price went up for a while and then it went down, and then you have the other examples where consumers in one market have higher prices and in another market have lower prices.

And just to stick with consumer welfare, in both those cases we're going to have to do some sort

of aggregation. That's where George answered when he talked about discounting for the present value over time, and that's where I think the conversation was going also. Was it Dennis' point about there being one consumer who's harmed, but 99 percent are benefited. We don't give every consumer an entitlement. You're going to have to do some sort of aggregation no matter how you do it, but you can do that within the consumer welfare standard; you can do that within the total welfare standard. It's a different conceptual problem from the choice of the welfare standard.

CHAIRPERSON GARZA: We'll take the round again to you, then, Don. Do you have additional questions?

COMMISSIONER KEMPF: I have four quick things I'd like to touch on. The first is just an observation. It's to the two agency representatives, and that is, both of you commented on what you said the public perception is that, gee, they don't really take account of efficiencies, and, trust us, we really do.

I think one reason for that disconnect may

be the difference between the top brass and the staff. The top brass changes periodically and frequently, but, like diamonds, the staff is sometimes forever.

[Laughter.]

COMMISSIONER KEMPF: So the staff--

MR. HEYER: I resemble that remark.

COMMISSIONER BURCHFIELD: He called you a diamond.

COMMISSIONER KEMPF: Sometimes, as things progress and develop and nuances come along, it has been my experience, at least, in the trenches that, while there's a receptivity at the high end for changes--or developments, let me call them, sometimes the people who are assigned the case are less amenable to those same things, and that may be the reason for the disconnect, because the practitioner has one or sometimes less meetings with the top brass, but daily communication with the operating staff who was assigned the case.

Anybody want to comment on that? It's just an observation.

MR. HEYER: Well, there are many different

staffs, and, you know, there are going to be people who have different views and make different representations when talking with outside parties. But I think it is true as a matter of fact that in all transactions, before decisions are made, all of these factors are properly taken into account by the decision-makers.

COMMISSIONER KEMPF: Second, let me turn to the "nyah, nyah" syndrome, and I think one reason that I'm most comfortable letting the people who are realizing the efficiencies decide in the first instance how those should be allocated is that, as among choices as to who makes that decision, my general confidence is vested in them rather than anyone else. If they were to say, "Gee, we're going to use it for Hurricane Katrina relief, or we're going to use it for--you know, what the world really needs is a cure for cancer or a cure for the common cold;" if they really thought they had an opportunity to do the most good for society through that allocation, I'm reluctant to second-guess them. And I would assume that the comments by Mr. Rule about letting the producers do that aren't an anti-consumer

thing--as your paper makes clear, at the end of the day, everyone is a consumer, and the total welfare at the end of the day does more for consumers than any of these other tests. It's not an indifference towards consumers. Quite the contrary, it's a recognition that that is the best outcome for consumers that drives your thinking. Am I correct on that?

MR. RULE: That's what we always thought.

COMMISSIONER KEMPF: Third, I want to pick up on something that Commissioner Jacobson said to you, Mr. Rule, right at the very end, and that is, he asked you about--

COMMISSIONER JACOBSON: *Reiter v. Sonotone*?

COMMISSIONER KEMPF: No, no, no. That was at the very beginning.

[Laughter.]

COMMISSIONER KEMPF: It was when you were talking--when he talked about that there could be a loss of surplus by a competitor. Am I right that, when a competitor is disadvantaged by efficiencies created by the merger that either make it harder for him to compete, lower his profit, or even put him out

of business, that's not a loss of surplus; that's actually the byproduct of a gain in total welfare?

MR. RULE: That is generally how I understand it. Now, I will say, although I should--at the end of that, Professor Salop spoke up, because it's his example, and that's why I'm not sure how realistic it is. But if you assume that a company has 90 percent of the market and produces at $10 per unit, and two companies that, let's say, produce at $50 per unit and, together, account for 10 percent of the market, they can get together and they lower their cost to $40 and expand their market share to 25 percent or 30 percent, such that, in effect, they've taken--and what I don't understand about his example is he assumes output stays the same both before and after the merger. But the notion is that as a result of that, the producer who had $10 of cost and was generating more surplus in effect loses sales of, let's say, 20 units to the merged company, which is operating at a higher cost, and so overall producer surplus has declined.

It's interesting, and it's a nice mathematical model; I just don't believe it happens

in the real world. Generally, I agree with you that the sort of rough and tumble of how the market sorts out, you know, relative cost gains and taking away various sales from one another is best left to the market as opposed to having the antitrust agencies referee that shift.

COMMISSIONER KEMPF: At the end of the day, we're interested in the reality of competition, not the façade of competition. Would that be a good way of putting it?

MR. RULE: I think that's a good way to put it.

COMMISSIONER KEMPF: Let me--last point--turn to a question, Mr. Cary, that has been touched on in a number of things, including in now-Professor Muris' piece where he comments on the discrepancy--this is a quote--"the discrepancy between official government pronouncements regarding efficiency and the government's practice, at least in contested cases," which he views as a continuing one. And that's something I discussed in the past, and let me take a specific example and ask you about whether you have any comment in this regard. That is, what is

the difference between the analysis of a merger and, once the decision has been made to challenge a merger, what is done in the challenge of it?

And as several people, both on this morning's and prior panels, have commented on, there are a number of these cases that--people here did. There are a number of these cases from the '60s and '50s and '70s that have never been--Supreme Court cases that have never been expressly overruled, and they are decidedly out of favor. But, you know, *Brown Shoe* remains on the books as something that--no one has ever said, "We hereby overturn *Brown Shoe*," or *Pabst* or *Blatz* or *Von's*, some of the other cases mentioned. And the discussion--let me take a specific discussion. It was just before the *Staples* case was filed, and I was talking to the Chairman, and I said, you know, "You've been one of the main contributors to advancement in the area of efficiencies, and you've been a progressive thinker for a very long time. And if you authorize this case to be challenged, the staff will take all of the things you said and say it's a bunch of baloney, and you run the risk that something you care about, have

thought about, will be undermined in the enforcement process because the staff will do that." And he said, "No, they won't do that." I said, "Of course they will." And he said, "Why?" I said, "Because they're trial lawyers. At that point you've assigned them the case, and they want to win the case." And I said, "Looking at it as a trial lawyer, not as an antitrust theoretician, I would say they'd be guilty of malpractice if they didn't use those cases."

But it does create this issue that the staff, because its assignment is to win the case, and it can in good faith use not overruled precedents by the Supreme Court, may actually undermine developments in the law.

My question is, is my view of that correct--and I'm holding some briefs here.

[Laughter.]

COMMISSIONER KEMPF: And if so, what is your comment about that?

MR. CARY: Okay. First, there is that tendency; I will acknowledge that.

Second, I think that that tendency is reined in pretty well, and probably in those briefs that you

see, you will find that there is a pretty lengthy discussion about the appropriate treatment of efficiencies, and you'll find in the briefs, as you do in the opinion of the court, that the methodology of the Guidelines was pretty rigorously adhered to in that analysis.

So I think things like the Guidelines, which put the agency on record, notwithstanding the language in them that says these are for prosecutorial discretion purposes and not for litigation purposes, have the effect that we would all hope that they would have, namely, to make sure that the litigating staff at the agencies are, in fact, implementing the policy of the agencies.

Second, I would say, notwithstanding the fact that *Von's Grocery* has not been overruled explicitly, the history of antitrust law since that time and the history of antitrust law outside the merger context makes it pretty clear that Supreme Court precedent does not support the standards in *Von's Grocery* today. And I think if you compile the merger cases after *Von's Grocery--General Dynamics* and other cases--together with the non-merger law--

BMI and *NCAA*, *et cetera*, you can make a compelling case in a court, and I've seen it done, that *Von's Grocery* and *Brown Shoe* are not the state of merger law, and the current Supreme Court precedent in antitrust generally governs merger law as well.

COMMISSIONER KEMPF: Anybody want to comment, particularly from the agencies?

MR. HEYER: Remind me what the question was.

COMMISSIONER KEMPF: The question is, the disconnect that Chairman Muris and others see between what's used in-house to analyze something and then--

MR. HEYER: I remember now.

COMMISSIONER KEMPF: --a flip-flop that, when you go to court, that's all out the window, and you use all these old precedents to attack a merger, no matter how intellectually bankrupt they are.

MR. HEYER: I remember now, and, no, I don't really want to comment.

[Laughter.]

MR. SALINGER: Well, I don't know about the use of bad precedents, but I think the phenomenon you describe with respect to--the phenomenon you describe is true with respect to the use of the Guidelines,

and I think that, within the agencies, when we evaluate mergers, we're trying to get--you know, we're trying to take a holistic view of the merger, and we're trying to consider the efficiencies along with the anticompetitive effects. So there is more of a balancing that's going on within the agency and the decision process. But then once a decision is made to go to court, then we've got to make the case, you know, using the methodology, if you will, that has been established by the Guidelines. So the case that comes out is often, I think, different from the analysis that led to the decision.

COMMISSIONER KEMPF: Rick?

MR. RULE: Commissioner Kempf, let me just mention one thing. I think that, to some extent, the phenomenon that you talk about is a little bit of an institutional issue. My guess is, though, never having worked there, I'm not sure, that it would be harder for a Chairman of the FTC to control what is written in briefs that are filed by the staff attorneys. It's not difficult, though, institutionally at the Department of Justice. And at least, again speaking in somewhat dated terms, I certainly

recall, for example, when the first cases came up where the defendants were arguing that efficiencies were relevant because of the Guidelines, ultimately the cases that were used--because my guess is, though I don't have a specific recollection--the staff probably wanted to use *Clorox* to say that they weren't relevant. But the front office wouldn't let them, and ultimately, the staff came out with an approach that reflected where we are today.

So institutionally, it's harder for, I think, the FTC to control. It's not that hard, really, for the Department of Justice to control. And I think historically, the Department has done a better job in making sure that bad precedents aren't cited by staff.

CHAIRPERSON GARZA: I'd like to ask if some of the other commissioners have questions, and I'm going to ask the panelists to try to make your answers as short as possible so we can get you out of here when we promised. But, Commissioner Valentine, you had an additional question?

COMMISSIONER VALENTINE: Thank you. I'll be very brief, and probably you can be too.

This morning, David Scheffman mentioned that, or conceded, I guess, that he thought that *Superior Propane* was not the right answer and was not the right way to go. I'd be interested in whether each of the panelists think that the *Superior Propane* test that, as Michael said, our dear neighbors to the north used, is a wise way of thinking about and testing efficiencies. This is in the U.S. merger context and given U.S. political merger history.

And, second, what if cost savings were passed on to intermediate customers but not ultimate consumers? And if it helps to visualize--I hate to use the *Baby Food* case, but just pretend that grocery stores got cost savings but mothers buying food for babies did not. How would you come out on that? Do you want to start, Michael?

MR. SALINGER: I don't think *Superior Propane* was the right standard, at least for us, and I think that if you have a price reduction to the purchaser--if the grocery store gets the price reduction, that's sufficient.

MR. RULE: I am, again, skeptical about any standard that purports with precision to balance

allocative inefficiency and productive efficiencies--not because I don't think theoretically it's correct, but because I don't think it's possible, and that's why the sort-of rules that I suggest in the paper I think are probably preferable.

You know, I think by definition I don't need to say anything more. If you believe the total surplus or what I call consumer welfare is the right standard, then as long as the surplus is generated, it doesn't matter that it gets passed on in that sense in a direct sort of serial way to the final consumer of that product or what the final product is.

MR. HEYER: I don't know that the department has any position on *Superior Propane*, so I won't create one here.

COMMISSIONER VALENTINE: You're allowed to speak on your own.

MR. HEYER: As far as the other question about the price decreases to someone, but maybe not to final consumers, that's another way of asking the "do fixed-cost savings count?" question, and, you know, the Guidelines and agency practice permit us at

times to take into account, you know--you know the language about not short-term, blah, blah, blah. Cost savings are cost savings, and we do at least consider them.

MR. CARY: On the intermediate point, I think antitrust has enough difficulty in taking care of one market at a time, and I don't know that I would impose on the agencies the burden of tracing all of that through to the final consumer.

MR. BAKER: I don't think I know the *Superior Propane* standard well enough to comment, but from what I gather about it, I don't think it's what I would adopt. And the benefits to the direct buyers are good enough for me, and I won't look further.

COMMISSIONER VALENTINE: Okay. Thanks.

CHAIRPERSON GARZA: Commissioner Carlton?

COMMISSIONER CARLTON: I had one question. Let's suppose that the standard is consumer surplus, not total surplus, and there's a transaction that creates consumer harm but producer benefit: the total surplus goes up. That, by itself, creates an incentive for the firm engaged in the merger to engage in a transfer payment to the consumers to

bribe them so that their consumer surplus is positive. That means, say, in a market in which we have a few buyers, the merging parties can sign a contract with those buyers and guarantee that their price doesn't go up.

So I guess I have two questions, a two-part question, one to Rick, and then I'd like to hear Ken's and Mike's takes on this. If you adopt that standard, consumer surplus, then a firm should say, "You guys are worried price is going to go up." I offered a long-term contract for two years, or whatever, and either they turned it down, in which case that's their fault, or they took it, and, therefore, there's no harm.

So, one, isn't that an implication of what happens if you adopt consumer surplus as just some-- as an incentive to have an additional transaction? And, two, do you think that's a good way to go? Because that is the implication of the consumer surplus standard. Rick?

MR. RULE: I guess the point I would make is, if you were going to adopt a consumer surplus standard, it's probably not a bad idea, again, at

least conceptually, to allow it. And I'll be interested to hear what Ken and Mike have to say as well, because my experience is I think probably not that much different from a lot of outside counsel, but there's arguably a little bit of that that goes on, anyway. And a lot of times, you know, when parties have a merger, the first people they go and talk to are the customers, because they know those are the people that the agencies are going to talk to, and they try to persuade them that the merger is good, and that means good for them. And sometimes that involves at least some sort of understanding, maybe implicit or otherwise, about what's going to happen after the merger, and that then can influence what the consumers tell the agency. And that happens.

Now, my sense is that at least the lawyers at the agencies aren't particularly happy if they-- certainly if they think there's an explicit bargain taking place, because I think they view it as, you know, in effect, sort of tainting a witness that they potentially might have, and so they get a little bit upset about it. And, frankly, for that reason you've

got to be a little careful about doing those kind of deals as a practical matter. But it does happen, and I don't know, frankly, what the official position of the FTC or the Department of Justice is on that happening.

COMMISSIONER CARLTON: It seems like they should encourage it. That's why I'm interested in what you guys think.

MR. HEYER: There are many things I could say about a lot of the elements in your prong, but most circumstances in which something like that might happen in principle strike me as ones where you're talking about intermediate good-producers buying inputs. In circumstances such as that, it's not clear that buying them off is necessarily going to benefit final consumers.

COMMISSIONER CARLTON: Why is that? If the intermediate producers get a lower price? So their price doesn't go up.

MR. HEYER: Give them a check. Pass on the price increase.

COMMISSIONER CARLTON: No, no. I'm not talking about a lump sum check. I'm talking about--

MR. HEYER: Oh, okay. So now we're dealing with the specifics of exactly how the pass-on occurs through the intermediate good-producer--

COMMISSIONER CARLTON: No, no--

MR. HEYER: Can't be a check, it has to be a price decrease.

COMMISSIONER CARLTON: No, no. No. I sign a contract with the customer, who's an intermediate producer in your case.

MR. HEYER: Right.

COMMISSIONER CARLTON: And it lowers--it guarantees that his price won't go up. I sign a long-term contract with him. That's his marginal price, and then, you know, I assume he's in a competitive market.

MR. HEYER: In theory, something like that seems like it might work. I think it might run into issues of observability of the contract being enforced over time and issues of regulatory evasion, sort of, where you get into, you know, it was a contract that wasn't being entered into initially but now it's part of getting the deal through, and you worry about what might happen after the deal gets

through.

But, you know, in principle, sort of like a monopolist perfectly price discriminating, the world is better, so why should you worry about having monopolies? It sort of has a little bit of that flavor to it, but, I mean, it's an interesting theory.

COMMISSIONER CARLTON: Mike?

MR. SALINGER: Well, if you could write and enforce these contracts costlessly, I think there would be no efficiency implications, you know, sort of a Coase theorem kind of issue.

COMMISSIONER CARLTON: Yes, the Coase theorem, right.

MR. SALINGER: You know, so I--but I think the standard does matter. If you have a small enough number of buyers so that you could write these contracts, I don't think you should do anything to stop them. But I think, as a practical matter, you wouldn't--they'd be hard to write, and so the welfare standard really does matter.

MR. BAKER: May I add--

COMMISSIONER CARLTON: Sure.

MR. BAKER: You've identified a virtue, I think, of the consumer welfare standard. It pushes the firms to figure out how to revise their transaction to make sure it benefits consumers. It doesn't have to be with your contract. It could be in lots of other ways. And that's a good thing, and particularly when the firms have a better idea of what a less restrictive alternative is than the agency, and the agencies can't second-guess that as easily. But I'm with the other panelists. If you could actually--it's going to make it tough in practice. You've got to make sure they really stop exploiting the consumers in all dimensions except price--I mean, including price. In your contract, you've got to be able to enforce it. But on the whole, if you could do that, it seems to me that would solve the problem.

COMMISSIONER CARLTON: I'm just saying that's an implication of the consumer standard. You're forcing firms to engage in these types of actions in order to get the deal through, which might have transaction costs.

MR. BAKER: But it's a good thing if

that's--if it deters bad deals on average rather than deterring good ones.

CHAIRPERSON GARZA: Commissioner Warden, did you have--oh, where did he go?

COMMISSIONER WARDEN: Just a quick follow-up to Commissioner Kempf's question about, I will call it, the cure for the common cold.

Mr. Rule, your willingness to use the total welfare test, I'll call it, doesn't depend on whether the producer's surplus that might be generated goes to an Ebenezer Scrooge or a Mother Teresa, does it?

MR. RULE: No, it doesn't.

COMMISSIONER WARDEN: Thank you.

CHAIRPERSON GARZA: Commissioner Jacobson, you said you needed 30 seconds.

COMMISSIONER JACOBSON: Thirty seconds. One, the problem identified by Mr. Kempf about *Von's* and *Pabst* being on the books I think is mitigated almost completely by Ralph Winter's decision in the *Waste Management* case and other cases that fundamentally make the Guidelines an estoppel against the agency. So I just don't think it's a real-world problem.

Second, a merger that creates the power to enter into a contract to refund the overcharge should be prohibited for exactly that reason.

CHAIRPERSON GARZA: Well, I want to thank the panel for appearing here, subjecting yourself to our questions, for submitting your statements to us, and for the thoughtfulness with which you've approached this. We hope that you continue to remain interested in the activities of the Commission, and thank you again.

[Recess taken.]

CHAIRPERSON GARZA: Good afternoon. Let's open the hearing on The Hart-Scott-Rodino second-request process.

Let me just briefly explain how we'll proceed this afternoon.

First, I'll ask each of the witnesses to take about five minutes to summarize their written testimony, and I will start, if it's all right with Bob Kramer--I'll start with Ms. Creighton and then you, and then we'll go to our non-governmental witnesses.

After you've given your five-minute

statements, then we will have lead questioning this afternoon on behalf of the Commission by Commissioner Valentine, for about 20 minutes, and following that, we will allow each of the other Commissioners time to ask questions, initially limited to five minutes each. And we ask that everybody try to keep their answers and questions short so that we can take full advantage of the time.

You'll see that there are lights on the table, on each of our tables. When you see the yellow light flashing, that means you have a minute left. And when you see it red, that means that your time is up.

So if you do see it red, if you could try to wrap up whatever it is that you're saying, I'd appreciate it.

With that, let us begin with Ms. Creighton, if you'd like to summarize your written testimony please?

MS. CREIGHTON: Thank you, Commissioner. I'm delighted to appear on behalf of the Federal Trade Commission to discuss the issue of the Hart-Scott-Rodino merger review process.

I should add, however, that the views that I express today are my own and do not necessarily reflect the views of the Commission or any individual Commissioner.

Because the HSR review process is the principal means by which the Commission investigates and analyzes mergers, the Commission has a strong interest in an efficient and effective process that prevents mergers that harm consumers.

At the same time, the Commission is keenly aware of the cost, both in time and money, that the merger review process may impose on transactions that are wholly or largely beneficial to consumers. And the Commission is eager to work towards ways in which these costs can be reduced, consistent with its consumer protection mission.

In recent years, two trends, one technical, the other substantive, have led the Commission to conclude that we need to undertake a top-to-bottom review of our existing procedures.

The first trend is familiar to anyone who has been involved in the HSR review process during the past several years, namely the explosion in the

number of documents maintained by business firms.

The second change that has occurred since the time the Hart-Scott-Rodino Act was enacted is the evolution of substantive merger analysis, away from structural presumptions and towards a more economically rigorous analysis of likely competitive effects.

In recognition of the challenges that these developments have posed, Chairman Majoras has embraced the goal of reducing the burden on the Commission and the parties posed by the review and production of large volumes of documents, while at the same time ensuring and enhancing the effectiveness of the Commission Staff's substantive review.

In her comments at the ABA Fall Forum one year ago, the Chairman announced a significant initiative aimed at accomplishing these objectives, with the creation of a merger process task force at the Commission.

This week at the Fall Forum, the Chairman stated that she intends to roll out some significant reforms to the merger process in the near future.

The merger process task force has consisted of 18 attorneys, economists, and managers, most of whom have a decade or more of experience investigating cases under the HSR regime.

The task force has spent the past several months assessing the merger review process at the Commission and is now in the process of developing proposals to change the way in which we engage in our review process, consistent with our enforcement mission.

Our changes will be based on the work of the task force, as well as consideration of past reforms, informal input that we've received from the ABA, input from practitioners who have offered their opinions along the way, and a detailed review of recent HSR matters in each of our merger divisions.

The Chairman has asked us to consider changes that will make a difference, including, for example, options to reduce the size of productions through smaller search groups and a shorter time period covered by the second request, and to reduce the burdens associated with such requirements as preserving back-up tapes and compiling detailed

privilege logs.

In addition to the work of the merger task force, the Bureau has recently adopted a number of internal procedural reforms aimed at increasing the rigor, focus, and accountability of our review process.

These include detailed second merger screening meetings, tougher review of second requests at the issuance stage, the involvement of the Bureau's front office, and the development of detailed investigation plans and similar practices.

Through increased Bureau and management involvement and accountability, we believe that, in the coming months, you will find material substantial improvements in the merger review process at the Commission.

I look forward to your questions. Thank you.

CHAIRPERSON GARZA: Thank you very much. Mr. Kramer?

MR. KRAMER: Thank you.

I'm pleased to be here on behalf of the Department. I will give a disclaimer also that my

views may or may not coincide with those of the Acting Assistant Attorney General.

But mergers have been the core of my practice for most of the 28 years that I've been practicing at the Department, so let me summarize the points that I would like to make today.

The Hart-Scott-Rodino process we view, and I view, while not perfect, is successful from any global view. The first goal was to allow agencies a meaningful opportunity to enjoin anticompetitive mergers before they occur and to avoid years of post-closing litigation and inadequate remedies.

I think back to the *El Paso* case, which was something like 18 years in post-closing litigation. This goal has been accomplished.

The second goal is to allow the mergers that are not competitive problems, and this constitutes the vast majority of mergers, quickly to get through the system. I think we're also accomplishing this very well. Approximately 97 percent of the acquisitions are cleared without a second request, and about 60 percent are cleared within 10 days.

Now, the Department of Justice over time has

made a number of discrete efforts to improve the process, and I think the most important was the Merger Review Process Initiative of Assistant Attorney General James, which has led to some measurable impact on review times at the Department.

I think the issue to be addressed now by the agencies with the help from the bar is the burden on the government and on the merging parties caused by advances in computer technology that have lowered document- and data-storage costs, and, as a result, have led to extraordinary increases in second-request productions, even where the request itself has stayed fairly constant over a period of years.

We are keenly aware of that need to address this every time we receive a large second request submission.

We have a real interest in reducing burdens, both to us and to parties, with the caveat that we do not want to be in a position of sacrificing the primary goal of Hart-Scott-Rodino, which is the meaningful chance to preliminarily enjoin mergers that would harm American consumers. Thank you.

CHAIRPERSON GARZA: Thank you. Mr.

Whitener?

MR. WHITENER: Great. Thank you.

It's a pleasure to be here on this great panel.

Let me give you a brief summary of my written statement.

I think merger enforcement is generally in very good shape in this country. Our system has been a model for a number of other countries. I think many aspects of our system should be followed by other countries as they develop merger control.

We have professional, highly trained staff. We have robust enforcement standards that are economically sensible. We have procedures that are generally fair, and the outcomes I think are much more often right than wrong. We also get a number of the details right, like the fact that the FTC's pre-merger office dispenses timely guidance on complex issues--really a model for public service.

So in the main, it's a system that works well.

My perspective, having been at the FTC and now working with GE for a number of years, is that

there is one aspect of the process that does need to be significantly reformed, and that's the second-request process.

I also think it's the aspect that is the most easily fixed. I think there are some pretty simple things, the agencies can do, without the need for legislation, and I will briefly describe some proposals here today.

Before I turn to second requests, I do want to just briefly mention one other issue that has been extensively talked about in other hearings, and that's the interagency clearance process.

And I just want to basically pile on to the comments of some others who've said that this Commission has an opportunity, I think, to do something very useful for the antitrust community, and that is to give the agencies the support they need to go ahead and complete the effort they attempted a few years ago to come up with an effective interagency clearance allocation agreement.

So, back to second requests. I think some of the technological changes that have taken place, in terms of electronic document storage capacity have

resulted in much more electronic information residing in the files of companies today. Also, analytical changes have led the agencies, the parties and the courts to look much more closely at econometric analyses of business data. There's a technological aspect to that as well, which is, there is more business data to be analyzed. So there is a feedback loop there, but the result is that a second request might on paper look very much today like a second request from five or 10 years ago, but it will result in a much, much larger production.

And the problem isn't just that the production is bigger; it's that the burden and cost of extracting the documents and reviewing them is much greater. Many more documents are pulled from the files of individuals than are actually produced, and are reviewed for responsiveness and for privilege.

So there are a number of costs involved. Burden and the delay are also issues that are very important. And I think what results is a system in which the burden now, pretty clearly it seems to me, outweighs the benefits.

The important thing is that there are changes that can be made that would not impair the government's ability to do its job. My proposition is that these changes would allow the government to be more effective and more efficient in both investigating transactions and preparing for litigation if necessary.

The other thing I want to note about cost is that it's not just a question of monetary cost. There's also a cost in terms of respect for the system that happens when business people--who I think generally understand that the government has to take a close look at deals that raise antitrust questions--come into contact with the second-request process, which can seem to them extremely inefficient.

So very briefly, I want to focus on the document issue, and then I will address very briefly the data question.

In terms of documents, my proposal is to put a cap on the number of individuals that are subject to a typical search.

I think this can be done while still

providing the agencies with the information that they actually typically use in investigations. I think an internal candid self-assessment by the agencies would verify that. I think the number could be fairly small; 20-25 are the numbers that I've talked about. The key question really isn't what the exact number is; it's that there is a substantial reduction, and that this is done across the board, because I think it needs to be a system that can be clearly articulated and effectively implemented.

And I think the parties need to provide the information that the agencies will require to make this determination, but the agencies have years of expertise with the system, and I think they have the capability to make a judgment up front that they can accept documents from a much smaller number of people than is typically the case today.

The number of people is the critical factor in determining how many documents have to be collected, reviewed, and produced, and in determining how much the overall effort costs.

The second aspect of my proposal is that the time frame covered by the second request should be

limited. The typical model second request looks at a three-year period. Often, that's expanded in practice. I think two years would work.

I think these limitations can significantly reduce the volume of documents, and the burden and costs, associated with the second request process, without impairing the government's ability to do its job.

My time has expired, and in response to questions I would be happy to address another issue, which is how to deal with non-cooperative parties or questions of bad faith in the implementation of these reforms, because I entirely agree that good faith on everyone's part is essential to make any reforms work. Thank you.

CHAIRPERSON GARZA: Thank you. Mr. Wales.

MR. WALES: Sure. Thank you very much. It's a real honor to be here today.

I'd like to start off with a quick observation that I hope will not be too controversial, and that is that, contrary to the intent of the original drafters of the HSR Act, I think the process has essentially become government

regulation.

A few mergers actually go to litigation, and there is little to no core review of the agencies' actions today.

In any event, I believe that most would agree that the outcomes reached by the agencies pursuant to this process have been, by and large, correct.

In fact, there could be fewer errors with agency review than there have been with litigated cases.

In most cases, agency review will be no less efficient than litigation.

With that said, however, agency review today does lead to instances where outcomes are distorted by the process, and the cost of the review can be excessive.

In looking at ways to improve that process, I thought it would be helpful to consider the three basic types of transactions.

You have your "no-brainer" cases where, in essence, they are reportable transactions with no serious antitrust issues and the agency allows you to

proceed without any action.

You then have what I call "purgatory" deals, which are more in the middle, where there are actually significant antitrust problems, but the rest of the deal is going to be clean and the problems that do exist can be fixed.

Last, we have what we call "show stoppers," which are deals where there are real issues, and the problem is that they cannot be fixed, because it would destroy the value of the transaction.

I'll start with no brainers, because most transactions should fall in this category. It would make a lot of sense to spend some real time trying to build up efforts to increase efficiency in that area.

First, and I'll pile onto Mark's comments, it should be no surprise to anybody that the clearance process is broken and needs to be fixed. The clearance system proposed in 2001 would have assigned certain industries to each agency and was a good solution, because it would have allowed the agencies to really have core competence in certain industries, which leads to more overall efficient resolutions of transactions. And, of course, it

would have eliminated the clearance battles that seem to be brewing in the past short period.

Second, we should also try to reduce the burdens in these areas. First off, searching for, and producing 4(c) documents to the agencies, we find to be very burdensome, and certainly, the downside of missing documents is very high, so I think it would be a good idea to try to reduce that burden for these transactions where there really are no antitrust issues.

For example, what you could do would be to have a short-form filing, which allows parties to submit a limited number of 4(c) documents if they believe the transaction does not raise substantive issues.

The agency could then request additional 4(c) documents if it did not agree, thereby extending the waiting period and requiring that all 4(c) documents be submitted.

In addition, much of the information on the HSR form really is not necessary for a substantive review. For example, many of our clients spend a lot of time putting together the revenue information that

is required. And we have been told by staff on numerous occasions that they rarely look at the rest of the HSR form. From the staff's perspective, it is really just the 4(c) documents that they want to see, so hopefully, we could try and cut down some burden here.

Third, I think it would also be a good idea to be able to make the timing of the HSR reviews more flexible. In the current situation, the initial thirty-day waiting period cannot be extended other than through the issuance of a second request, even if the agencies are likely to resolve any concerns with a little more time to review the transaction.

And again, this does happen, unfortunately, during clearance battles. To avoid a second request in that situation, parties often pull and re-file the HSR forms, thereby restarting the 30-day waiting period.

Implementing a formal process for extending the initial waiting period for a limited time, some time less than 30 days and without a refiling, would be more flexible and less burdensome while accomplishing the important enforcement goals of the

agencies.

Next, for purgatory deals, where litigation is really not an option, but the agencies have determined a fix is necessary, the problem is that the process can get bogged down, especially when the parties want to avoid complying with burdensome second requests.

As a result, the agencies have superior leverage in negotiating the fix that might be required.

Negotiations can be drawn out under these circumstances if the agencies insist upon stringent remedy requirements, such as clean sweeps, up-front buyers, or perfect viability of divested assets, where the merging parties accept the complete risk of execution.

What we should consider is adopting more of a balancing standard when evaluating remedies, where the costs of those remedies are balanced against the benefits.

Second, it would be a good idea to look at trying to streamline the process of reviewing consent decrees and the remedies. I think one distinction

that has been apparent is that the FTC has a compliance staff that gets involved with negotiating consent decrees, while DOJ does not. And one can--we should look at whether the FTC's system or the DOJ's system makes more sense.

Third, I think it would also be a good idea to give parties another option in terms of implementing divestitures through a modified transaction. The agencies have taken the position in the past that a court should examine the original transaction if challenged by the agencies, not the modified one, and that any fix must be in a consent decree.

The problem with this approach today--and there's some recent examples of this in the *Libbey* and *DFA* cases--is that courts do look at the modified transaction.

One way to address the issue is to create a formal process under the HSR Act whereby the parties could file under HSR and actually report the modified transaction and have that reviewed.

Lastly, and to conclude, we have the show-stopper deals, where the parties have two options.

One is to try to convince the agencies that there is not a problem or that a fix is not necessary, but absent that, they can litigate.

Many times what happens is there are instances where the parties realize that they are not going to be able to persuade the agencies and the cost of delay would outweigh going through the entire HSR process. Thus, it would make sense to try to come up with a process that allows litigation to happen sooner.

That could be done with certain timing arrangements that collapse the second-request process with discovery, and perhaps, substantial compliance occurring on a dual track in that context. Thank you.

CHAIRPERSON GARZA: Thank you. Mr. Collins.

MR. COLLINS: Thank you, Madam Chairman.

I'd like to express my appreciation to the Commission for allowing me to appear before you and express my views.

I suspect that the most interesting part of this will be the questions and answers, so with your permission, I would be delighted to waive my five

minutes for an opening statement.

CHAIRPERSON GARZA: Is that okay? Then, Commissioner Valentine, would you like to proceed?

COMMISSIONER VALENTINE: Sure. Good afternoon, one and all. Thanks for your testimony, and thanks for sharing your time with us this afternoon.

I'm going to, I guess, try to focus first on the first 30 days, and then I think where we probably most wanted to put our time is the second-request process.

But I think what I'm hearing is that if we were to resurrect or encourage the agencies to resurrect the clearance agreement, we would pretty much solve the problems of the first 30 days, and the only additional tweaks on things for the first 30 days that I've heard are eliminating the NAICS code or at least the year NAICS codes; extending, by agreement of both sides, the 30-day period for a limited and fixed time to allow for--essentially to accomplish the same things we accomplished with refiling, but to avoid the sort of silliness of refiling, paying the fee, recertifying, *et cetera*.

I'm going to hold on the 4(c) production, and address that later I think.

And I'd like to start with Susan and Bob and give them a chance to respond to whether the NAICS code are things that you actually rely on to identify product overlaps or whether they could be disposed of, and whether that's sort of an extension--it might not be more efficient and rational than the current gerrymandered system.

MS. CREIGHTON: I'd be happy to start.

MR. KRAMER: Always happy to defer to the senior official.

MS. CREIGHTON: As I think you suggested, Commissioner Valentine, I understand Mr. Wales to be raising two issues with respect to the NAICS codes. The first is, do we really use the 1997 data, given how dated it is, and then second, and more generally, do we use the NAICS revenues at all in our analysis?

The first question is easy to answer in that we are in the process of getting the base year updated to 2002. We have to wait for the Census Bureau to give us the information in order for us to be able to bring forward the base year information.

They gave the information to us this summer, and we expect that we'll have 2002 as a base year here very shortly.

With respect to whether we use the NAICS information at all, it may be that there's a little bit of a disconnect because there is a difference between the information used by the pre-merger office and that used by the investigating staff, for example, in market definition, once a second request has been issued.

COMMISSIONER VALENTINE: I'm more interested in the pre-merger office using it, to simply eliminate the--

MS. CREIGHTON: Right. Because the NAICS revenues are absolutely indispensable to the review that the pre-merger notification office does: determining whether there are overlaps and making the determination whether we can grant early termination within a week and a half or so.

And so, far from accelerating the process of our review, I think eliminating that information would greatly extend the time that it took us to make a determination with respect to the 90 plus percent

of deals in which we're able to grant early termination simply on the basis of the parties' information constrained in the parties' filings.

COMMISSIONER VALENTINE: Okay. And on the extension theory rather than refiling?

MS. CREIGHTON: On the question of whether--

COMMISSIONER VALENTINE: Rather than refiling it to get the additional 30 days to try to determine whether, in fact, a second request wouldn't be necessary. Could you simply--wouldn't a system where the two sides agree to extend, let's say for 20 or 30 days, be more sensible?

MS. CREIGHTON: There seems to have been a factual predicate to the proposal, which was that there might be some difficulty with parties being able to pull and refile within the two days.

And so that the current system has had--

COMMISSIONER VALENTINE: No, I think it's simply that it would be more rational and efficient to not have to pull, refile, repay. Let's say you get it in in three days.

MS. CREIGHTON: I don't have any particular observations or objections to offer on that other

than that I was simply going to make the factual observation that I'm not aware of anyone having failed to be able to pull and refile within the two days and so incur the extra filing fee without--

COMMISSIONER VALENTINE: Okay. That's fine. Bob?

MR. KRAMER: I would agree that the NAICS Codes are very important in the initial review of the Hart-Scott-Rodino. We emphasize that when training staff; it's in the Division manual. It's one of the things that staff is trained to look at first in terms of trying to determine whether there is an overlap or not. So I consider it very valuable. As Susan said, it is being updated to get--the 1997 information is obviously at this point old--2002 is much more valuable, and we're happy that change is going to happen fairly soon.

COMMISSIONER VALENTINE: Yeah. And I'm not sure practitioners would really want a less objective standard. I mean if they were--

MR. KRAMER: Sure.

COMMISSIONER VALENTINE: --asked instead to define relevant product markets and identify where

the overlaps were, I mean I think we have always normally gone around the world telling the rest of the world that they ought to do it our way, so that's sort of all I need--

MR. KRAMER: Absolutely.

COMMISSIONER VALENTINE: --on that unless either Dale or Mark are somewhere way off the charts on that?

MR. COLLINS: If I could add one thing. And it may be that I'm too distant from this to actually have a proper perspective on it, but first of all, let me say, I defer to the officials from the enforcement agencies on the usefulness of the data.

But as far as the cost is concerned, I must say, and this is where I may be too far away from it, I mean my general impression now--this has been around for 20 years. Most of the companies have systems in place through which they can actually produce this information very inexpensively.

COMMISSIONER VALENTINE: Yeah. And we--

MR. COLLINS: So I don't consider this to be a particularly large burden on the companies, although as a matter of good government, you know, if

the information is not all that useful, and I'm not saying that that's the case, but if it was, then you should eliminate it. I think, you know, as much as anything what I see are the companies that come in, particularly from the Pacific Rim, who haven't done Hart-Scott-Rodino filings before. They actually can get the code though, pretty quickly, because it's their U.S. operations that are doing it.

What they have problems with is the Item 6 information, which sometimes can go on for hundreds of pages.

COMMISSIONER VALENTINE: Right. All right. Okay. Time. Sorry. I only have little time, so, Mark?

MR. WHITENER: I would just add that I defer to the government in terms of what information they believe is useful here--they are doing a very good job in the initial waiting period generally, and I wouldn't want to take anything away from the government that's useful in that regard.

I want to echo Commissioner Valentine's point about international issues, and express some unease about tinkering with the initial 30-day

waiting period.

That initial waiting period has the value of clarity. Other governments have adopted similar waiting periods, and I'd want to think carefully about the implications of making it too easy to automatically extend it, even by agreement, where there might be perceived pressure on the parties to do so. So if the effect was to undermine the clarity of that initial waiting period and to set an example that other countries might follow, I would want to think very carefully about that.

COMMISSIONER VALENTINE: Okay. Okay. Second phase, second request.

I think that Mr. Whitener has made some rather enlightening suggestions about ways to limit the second request, and here, too, I guess I would like to start with the agencies and see to what extent they would be willing to go along with a system where there was a general presumption that one could identify 15 to 25 or 30 officials whose files were to be searched, that the number of years would be two or three. And I'm happy to hear your views on that, and we'll hold off on numbers of

interrogatories and scope of the request. Just focus on those two main variables.

I have recently had some huge success in doing precisely that with the agencies in some transactions I've worked on. The beauty of it, it seems, from my perspective, is that ultimately, those presumptions then place the burden on the agency to go to you guys--to Susan and Bob--and say, "No, we need 40 people's files. No, we need five years," rather than the parties' appealing through a process which, much as we try to make it independent, is not a terribly effective process when we actually look at what happens to appeals of requests to modify second requests or appeals of disputes over second requests.

MR. KRAMER: Well, I think I would agree that Mr. Whitener's proposal is--it's a good faith effort in the dialogue that is going on right now. We have questions about the right way to limit the burden, but we're open to that type of discussion.

And let me just raise a couple issues that we're grappling with.

One is what do you do on--how fixed a number do you want to have? Should it be 25? Should there

be a single rule for all transactions or what about the 20--what about the deal with 20 product markets versus the deal with one product market? How do you articulate what the rules should be between the two of them?

An alternative way of doing it, and I haven't made up my mind which is the best way to go, is to focus on positions, for example--whether you should be looking at something like senior management, plus what I'd consider product managers--product sales managers, or product marketing managers types of levels--and getting into a particular level in a corporation.

I don't have a view currently as to which of those is the best way. But that is the type of discussion that we're having right now.

We're seeing about 50, 55 percent or so of the documents that are critical probably to a PI hearing, coming from that sort of vice president and senior management level and maybe another 20, 30 percent coming from the product manager level, and then, in some matters, positions below that, often on very discrete issues. There may be ones where

closeness of competition is such an issue that there are certain documents needed actually at that transaction level that may be in a lower level official's file.

So there are some real questions about how to do all of that.

I don't think we have a clear view as to how long a time period we should require documents. Two years obviously cuts--by itself, cuts the production in half, for example.

But economists are interested in looking at natural experiments, and sometimes there are natural experiments that have happened throughout a five-year period.

Someone enters. Someone exits the market. Some large technological change has happened--

COMMISSIONER VALENTINE: But what you might be able to get, through either more targeted searches than in searching all documents--

MR. KRAMER: Everybody, possibly, and that's one of the things that I think we'd have to think about, whether you would have some particular questions in second requests that obtain documents

wherever located or possibly going back further, maybe data requests that go back further to get at particular things.

COMMISSIONER VALENTINE: Yeah.

MR. KRAMER: But that's the realm of discussion that we're having.

COMMISSIONER VALENTINE: Susan?

MS. CREIGHTON: We agree that two of the really key variables that we need to focus on, and have been focused on as part of our review of how we go about conducting HSR review, are the time period and, even more importantly, the number of custodians that we review.

We've been very involved for the last several months in going back and looking at our investigations, looking at how many custodians, in fact, were searched. What kinds of information were solicited from them? And I think that's something we're very focused on and agree is a very important issue.

In the course of our review, two additional issues have come to the fore, and I think Mr. Whitener and Mr. Kramer have touched on both of them.

The first is that it has become very clear that cooperation by the parties really is indispensable for us to be able to engage in any kind of meaningful reduction in the number of custodians searched. Even under the current process, the more forthcoming parties are able to be in terms of providing organization charts, information about how their data is organized, how their products relate to other products in the market, and so forth, those all have been really key in the merger reviews in which we've been able effectively to reduce the number of custodians searched. That kind of up front work with the parties consistently has been a key factor in getting the scope of the search narrowed.

The second and perhaps more intractable problem is that as our merger review has gotten more sophisticated, the less we're able to base our decision on a small group of hot documents in the offices of a handful of key executives. Increasingly our analysis turns on issues that require documents that may not be found in those offices. For example, what does the evidence show regarding previous events of entry and exit in related markets? What were

previous experiences with efficiencies gained in prior mergers and the company's claims of efficiencies?

Particularly, when we have multiple markets, whether it's product markets or geographic markets, we're often looking very closely at pricing information, bid events, and other similar information that may or may not be kept centrally by the company. Commissioner Valentine, as I think you were suggesting, a lot of that information can be gained by having broader searches that aren't targeted at individuals, but instead may require a request that states, "Wherever these files are kept, we need this information."

In sum, we're continuing to grapple with how we can ensure that we are being as targeted as we possibly can, and still ensure that we are able to conduct the kind of substantive analysis that has informed our review process in the past few years. As I mentioned before, an important ingredient in that, and something we're looking at and are committed to, is having our senior management and front office integrally involved in the process early

on.

COMMISSIONER VALENTINE: That would be the theory I think behind Mark's suggestion that the burden to go beyond the 30 people or the two or three years would actually get you involved.

Any quick--Dale?

MR. COLLINS: Yeah. Just quickly. I mean, as a defense counsel, I'm all for more limitations rather than less. But let me take two things on that. That's one.

Secondly, what we've observed, at least what I've observed and a number of, you know, colleagues in the bar I think have observed--I won't say everyone, but enough--is that the ability to actually effectively negotiate limitations on the number of people to be searched and the identities of those people have been exceedingly time consuming and often very frustrating. And as a result of that, a number of us just simply don't do it. Okay?

It's easier to go out and just search everybody that's reasonably, you know, within the catch basin, and just get it done as opposed to negotiating for weeks on end, while you're largely

held up in doing your production in the first place.

And, having said those two things, I will say that, as someone who was a former government official, I'm really quite wary about imposing these kinds of limitations on the agencies. I mean I think very much should be imposed inside the agency, but from an external source, I'm against it.

MR. WALES: If I could make one comment, too. I think it's hard especially to have a one-size-fits-all for the number of people who are searched. It may be difficult to have a specified number, because obviously, companies are very different; industries are very different. As Bob pointed out, there might also be many products under review in a given transaction. But if it is true that the agencies have recognized that--and my math is not so great--but if you said 50 percent of the high-level people and maybe 25 or 30 percent of the VP-level have the documents that you need for a PI hearing, then maybe the line you try to draw is by responsibility, not by head count.

COMMISSIONER VALENTINE: Okay.

MR. WHITENER: A couple of things that Bob

said are interesting. It seems to me the government should have the maximum flexibility to do its job with only the limitations that really are necessary to reduce the burden.

What I'm describing here is not a legislative solution. It would be a self-imposed solution that the agencies would presumably consider and decide made sense. And if they don't, obviously, they won't do it.

How they would implement a numeric limit on document custodians in terms of which people to choose, it seems to me, ought to be, to the greatest extent possible, up to the government to decide, and if it made sense to rely on corporate positions or other sorts of criteria that experience suggested are useful, I think that should be left to the agency's discretion.

In terms of whether one size fits all, every deal that each of us has ever done had something about it that made it different. What they had in common was that the second request response is typically quite large. And in terms of documents, it seems to me pretty clear that as merger analysis does

often shift to other things like quantitative analysis, the reliance on documents goes down. But more importantly, I think the ability to focus on documents from a smaller group of people goes up.

Susan mentioned something about the importance of good faith, and I want to take this opportunity to comment on that. I think it's a very important issue for any reforms. But it's no more important after reform than before.

We do a lot of deals, and my sense is that we and our counsel have a constructive relationship with both of the agencies.

And if we didn't, I don't think we'd be able to negotiate, for example, limitations on document custodians, which we routinely do. Sometimes it can take too long to negotiate that, but often it's effective, and I think if we had a starting point and agreed that the number we're going to end up with will be significantly lower tomorrow than it is today, we would have done something useful for the second request system.

COMMISSIONER VALENTINE: Okay. Let me just--my time is up, but I just want to flag one

thing for Susan and the FTC, and you can get back to us with this, if that's easier.

Mr. Sunshine's paper, and, therefore, David, I guess by definition today, has some interesting numbers on the time taken in second requests for mergers in which the FTC does take longer than the DOJ, and it may just be that the--those numbers include, you know, certain bizarre outliers, like *AOL-Time Warner*, and there's really effectively not a difference.

He suggests that the length in time is attributable to the separate compliance office and that, in fact, to work out remedies, it's actually taking you longer to bring the compliance shop in. I actually would have thought that an expertise--your sort of an efficient targeted shop that deals a lot with remedies would be quicker.

And I'd just like you all to address that sort of--the question that he raises, and see if you can give us any insight into why those numbers for the FTC may be greater than for DOJ.

All right. Thank you.

CHAIRPERSON GARZA: I think as we--as others

have said that the issue of second-request burden is an important one, because it can, at some point, undermine the general enforcement goal, and I think everyone has recognized that for reasons not necessarily related to the agencies doing something different, but simply to the way that companies keep data and documents now, it seems to me that it has gotten to the point where the expense of complying with the second request is causing some people to question the whole system, and I think that's a bad thing.

And so, I applaud the agencies for responding to that issue unilaterally. I thought that what you described in your testimony about what you're undertaking at each agency seems to me very significant and likely to result in substantial improvements.

The other thing I'll just note is that the--you know, earlier today, I think it was Bill Baer who was pointing to the FTC's statistics that had been released a while back that indicated that hot documents, in fact, were not relied on in very many of the challenge cases, and that cases that were

challenged were often challenged without the benefit of hot documents. So when you have statistics like that, I think again it begins to be a little bit more difficult for business to understand exactly why it is that they're complying with the burden of producing the amount of data and documents that they do produce.

The other thing that is--stands in contrast is the European experience, and that's where I really wanted to ask a question. I wanted to put it to Mark, because I assume that GE is--your client has had the experience of having simultaneous review of transactions in the U.S. and in Europe, where they have very different systems, and I think probably Susan and Bob have some insight from having worked on transactions that are under review by the EU as well.

My question is, in the EU, of course, we don't have the enormous amount of documents and data, but we have them answering very similar questions in the same transactions and in a relatively similar time frame and coming to what appears to be, with some exceptions, possibly basic exceptions, the same answers.

And the question I have is, from what you've seen, Mark, and what you've seen, Bob, and Susan and also Dale and David, is there--I mean, is there some real difference in the quality of the decision making that you see in the U.S. that you can tie specifically to the documents? Is there some deficiency in the decision making in Europe that results from not getting the documents? Is there anything that we can learn from the way that the European system, the newer European system, has been proceeding that can help us in structuring our own review?

And I realize, of course, that in the EU, they don't have to go to court. And so my other question is whether there's something that could be done to change the system that would allow parties to get an enforcement decision, you know, maybe quicker on the basis of fewer documents and maybe deferring the production of a lot of documents to the instance where there's actually going to be litigation of a challenge?

So that's kind of long and wordy, but hopefully you understand what I'm getting at. Mark,

do you--can you respond?

MR. WHITENER: These are all great questions, and we think about them all the time, because we do spend a lot of time on multi-jurisdictional merger clearance.

One question you asked is about the quality of the decision making, and I won't punt on that. I think the quality of the decision-making is very high in the U.S. I think it's higher here than anywhere else.

I don't think that's necessarily the result of our process. I think it's more a result of experience and quality of the agencies' staff, the managers, the counsel and the courts.

And as others gain experience, notably in Europe, the quality of the decision making, the quality of the analysis increases, and it's getting closer to what we see here.

I mentioned the courts. I think the absence of meaningful judicial review is a critical issue for some other jurisdictions, and it's a very, very positive aspect of our system here.

The incentives aren't always for the parties

to go to court, but that option is there, and it's meaningful, and it's a very important thing.

The process differences between the U.S., the European system, and others mainly cut in favor of the U.S. system. I think most aspects of our process are very strong.

The one difference that in experience does not cast the U.S. system in quite as positive a light is the massive amount of material that is submitted in response to a second request.

I might well, if I were in Europe trying to decide how to do merger review, make sure that I got relevant documents. But I think that that would be a very limited inquiry. I think the European system works fine the way it is. But I wouldn't really adopt many elements of the European process here. I don't think that very many of the procedural aspects of other systems would import well here.

So, in sum, I think the U.S. system, which is more of a process of discovery and investigation, fundamentally is sound. It just needs some sensible reforms to reduce the somewhat out-of-control volume of material that we're dealing with. This is really

a volume issue, not a question of how we do it, fundamentally, in my opinion.

CHAIRPERSON GARZA: Mr. Wales, do you have a comment?

MR. WALES: I guess what I would say is the difference between Europe and the U.S. is really the extent to which the agencies use objective facts to make determinations. We have been involved in some recent transactions where the Europeans did not have a lot of documents, did not have a lot of information from the parties, but got information from other sources, sometimes customers, sometimes competitors.

I think the quality of the EU review can suffer from a failure to rely on objective factual data and economic analysis.

Thus, my observation is that often times company documents are important in terms of looking at a transaction.

Company data is also important to allow some of the models the economists do, and I think the European system could be improved. I am not saying the European system should be a mirror of our own, because obviously, we have our own challenges with

the burden, but I do think that they should rely more on the objective facts.

COMMISSIONER VALENTINE: Bob?

MR. KRAMER: Let me address the piece that you asked about whether a system could be put together that essentially postponed some of the real discovery that you would like for a trial on the merits, for example. And that is a real possibility. If one of the things we're thinking about is--I mean, because one of the questions that you ask yourself at every level in the organization, you go down and you sort of say, "We don't need that person; we don't need that person for a decision to bring a case or maybe even for a PI hearing or at least a reasonably quick PI hearing." But you'd really like to see that person's documents for a trial on the merits or an extended PI hearing. And whether a system could be put together that had some optional elements that would have some relatively severe limitations on whose files are searched, and in return, before there was some substantial hearing, there would be some guaranteed discovery right.

Now, that system wouldn't help the few show

stoppers that Steve and Mr. Wales talk about. And maybe they wouldn't choose that option.

So it wouldn't go to that, but I think there may be some room here, because, of the last 250 second requests that we've put out, we've litigated four of them. And that means that there's a whole lot of room there where a lot of transactions could save money and time, maybe even more importantly time, by having a shorter and more focused discovery by giving up certain discovery rights before there was a significant trial.

There are a lot of deals where they know they're probably going to be able to convince us it's not a problem. There are a lot of deals where parties know in their heart of hearts they're going to settle it or they're going to abandon it. And it might be an option for a significant number of companies out there, because I tend to think that the focus of reform should be on cutting the costs of those deals--that it can be--that aren't a problem or which are going to settle, and it's less about the, you know, one or two deals a year that go to court.

COMMISSIONER VALENTINE: Thank you. Susan,

do you have any comments?

MS. CREIGHTON: Yes. Let me continue with the distinction among three types of cases: cases that ultimately are headed towards resolution without any kind of consent; consent cases; and then matters that end up in litigation.

Our reform efforts really have focused on the first two of those categories. We are working particularly on ways to sharpen and narrow the focus of our investigations so that we can make quicker and better decisions with respect to the cases where we should close, or in the cases where some part of the deal requires a fix, but the overall deal otherwise would be allowed to go through.

I think the one part of the process that we haven't focused on as much are those cases where it's going to be "make or break." Do we litigate, or do we let the deal go through?

With respect to that last category of cases, in the four years that I've been at the Commission, I'm not aware of some gap in time between when a final decision has been made to challenge the case, and the actual filing of a challenge.

To the extent that there have been some suggestion about truncating discovery and making an earlier filing of the complaint, it may be that sometimes people perceive that staff have made up their minds, and then they continue to investigate.

Part of what may be going on is that management haven't made up their minds and are quite skeptical of the case, or that, at our agency, the Commissioners haven't made up their minds and are skeptical about the case.

And so a concern I would have about some truncation of the process for those make-or-break cases would be that effectively what you'd be doing is cutting out management and senior review as opposed to actually accelerating the process.

CHAIRPERSON GARZA: Thank you. Dale?

MR. COLLINS: Yeah. Just to comment on what Susan had to say, I think--I mean I agree with her as far as the problems about cutting out management, but I think that's easily resolved.

I mean, what you could do would be to basically an opt-out provision after a certain amount of time and discovery was allowed in the second-

request phase.

And then, when the opt out is essentially going to be triggered, right, then you give some additional time for management to review the case. And I think the critical problem is not the management review. That's an easy one to handle. I mean just so far as giving the time. You just put a lag on the--basically on when the agency has to make a decision. I think the more interesting question is how you determine that enough information has actually been collected in the second-request investigation as far as it has gone so that the agency can actually discharge its obligations under the HSR Act.

CHAIRPERSON GARZA: Thank you. I'm going to refer it now to Commissioner Jacobson.

COMMISSIONER JACOBSON: Thanks. I am going to pass out to the panelists and to each of my fellow Commissioners something I scribbled out this morning, and focus on just one issue, which is the number of custodians.

And this picks up on a suggestion made in Mr. Whitener's piece and in Ms. Valentine's

questions, and it's basically a structure that would force a limitation in terms of the number of custodians on the staff, absent intervention.

And just to go through it, for the record, the process would be that if a notifying party checks a box on the form, the initial HSR form, the following procedures would apply. If the box is not checked, there would be no change from current practice. The concept there would be to encourage people to 'fess up at the outset that this is a deal that the agencies may want to look at, and, if they do that, then they reduce the burden on them at least in terms of the second request process.

If you check the box, you provide complete organization charts. If they're not complete, you don't get the benefits. You also provide the name of a responsible officer--a corporate secretary, head of HR--someone who can really tell you where the data resides and where the people reside and who is who on that organization chart.

Once that's done, then, depending on the volume of dollars--this would be a very rough-justice system--depending on the volume of dollars, there

would be an arbitrary limit, at least in the initial stage, on the number of custodians. Here, just to be provocative, I've put 15 and 30. It could easily be, you know, 30 and 45. The number is not important. I think that the concept is, but there would be a fixed number based on the size of the transaction in terms of dollars.

And then if the agency concludes that it is a 20-product case, and 30 custodians won't do the trick, they'd have a process to go to a judge, an administrative law judge, some independent magistrate. So that's the idea. It's a variation on what Mark had suggested, and I want to start with Dale, because Dale indicated--without elaboration, I'd like you now to elaborate what the issue is with the sort of hard constraint on the agency in terms of the number of personnel?

MR. COLLINS: Well, I think that the--I think it was Bob who alluded to it, and that is that, at least in a lot of the second requests that I've been on the receiving end of, we've got multiple products. There are times when products emerge, you know, after the second request has been issued. I

think it's just a very hard thing to figure out who the right people are.

And let me just take that just one step further and go to your point number two?

COMMISSIONER JACOBSON: Mm hmm.

MR. COLLINS: I mean, as far as--I'm all for things like this, but I'll tell you we probably would never--at least my clients--I would probably not advise most of my clients to check the box, and the reason is that my clients are the types of--I mean, people like Siemens or Citicorp or Viacom. They don't have a clue what an accurate organization chart looks like. You know, they couldn't cough up one if their lives depended on it. I mean that was accurate at one point in time.

There are always--I mean, look, you know, the typical organization chart for one of those companies is somewhere between 600 and a thousand pages long, and they're always out of date.

So I mean we would never be able to say that we had a completely accurate chart. So--

COMMISSIONER JACOBSON: Even after some reasonable level of organization--

MR. COLLINS: Half the time, it's--you know, a lot of these deals--chemical deals, for example. I mean, a lot of the acts of the chemical deals is very down in the product. I've had cases where the company didn't even know they made the product that was an issue on more than one occasion.

COMMISSIONER JACOBSON: Susan, do you have--are you authorized to have any reaction to this suggestion?

MS. CREIGHTON: Well, without commenting, sir, on the precise details of your proposal, I think, first, that what your proposal recognizes is that there's an important component here about being able to work with the parties to get some up-front information. One of the things that you don't mention and that we've really wrestled with, and, still, to be honest, don't have a lot of good answers for, is what do we do about data, which is really a challenging problem.

So I would amplify potentially on the kinds of information that we would need from parties in order to be able to enter into meaningful efforts at limiting the scope of review.

Dale Collins mentioned something that I should have mentioned earlier, which is that there is an iterative nature to this process. So one of the other things that I think has to be part of any effective proposal, at least in terms of our internal analysis, is figuring out ways to make sure that we're able to take account of the fact that issues evolve. Parties don't always know what defenses they're intending to raise at the beginning of the second-request process, and their analysis becomes more refined over time. Ours does, too.

For that reason, the idea of having to go out to a court, for example, would impose an inflexibility that I personally would have concerns about.

But obviously, we're very much interested in finding ways that we can create practicable limits on the number of custodians that have to be searched, recognizing, as Mr. Collins indicated, that sometimes if you have 20 markets, and product managers all over the company in charge of those different product groups, it can be very difficult to limit the numbers to the kind of low double-digits that we're looking

at here.

MR. KRAMER: I'll try to focus on a couple points that are different, but I think go along the same way.

On the--you mentioned that the number 15 or 25 under your sort of dashed-off plan would be somewhat arbitrary, and I mean that is an issue when you get to how many products there are. Is there a failing-company defense in this particular case? Are they raising efficiencies? If we get 15 custodians, you know, do I look at efficiencies, or have I already used my 15 up somewhere else? Because product market is a real issue or failing company is a real issue.

So I think that we would be looking for some more consensual approach that has presumptions or guidance to staff about how to treat this.

As to the court order, putting aside the fact that a lot of second requests are decided at the last minute by the deputy, I'm not sure how this would even fit in procedurally, that, you know, you'd go in and get a court order in real time with the pressures of a merger investigation. I'm also not

aware of many situations where, outside of things with real constitutional issues like wiretapping and search warrants, the executive branch is told that, in order to conduct discovery, it has to go to a court.

So that's my reaction to whether there is a separation of power issue with that piece of it.

And the other thing is, just imposing a strict number of custodians raises the question: so what happens in those few cases where there is litigation, where the government has cut back substantially to 15 or 20 or 25 or whatever it happens to be? Are the parties free to say they want a trial on the merits or, in the FTC's case, a two-week long PI hearing in about three weeks after the filing is made.

So there are some tradeoffs that I think have to be made that aren't fleshed out in the particular proposal.

COMMISSIONER JACOBSON: Is this something that you're looking at in connection with--something like this in connection with the work that you're doing with the Commission now on the process review?

MR. KRAMER: We are--we've been talking about ideas such as Mr. Whitener's idea about--we've been thinking of it internally as possibly an amendment to the Merger Review Process Initiative that would, in much more detail, explain to staff what they should be doing in limiting numbers of custodians and where and how they might treat different options.

We still has a way to go in our thinking, because there are a lot of things where we have questions as opposed to answers at this point.

COMMISSIONER JACOBSON: Thank you very much.

CHAIRPERSON GARZA: Thank you. Commissioner Litvack.

COMMISSIONER LITVACK: Thank you. As someone who has been on the defense counsel, been in the government, and been in an organization that doesn't have an organization chart, I find this a very difficult question to deal with, and I think you've all made valid points. Dale's point about limiting--Bob's, too, obviously--about limiting the government in some ways is troublesome.

On the other hand, you all recognize and

give--and I don't mean this pejoratively--lip service, certainly, to the problem imposed upon the merging parties.

I looked at what John Jacobson did, and my first reaction, putting aside the organization chart issue for a moment, was why not? Why isn't this good?

And let me just--I'm afraid I'm going to talk more than I should before I get to the question, but I want to set it up properly. On the one hand, it was--I know from the defense counsel standpoint, you've got two goals in mind: get it done as quickly as possible and as cheaply as possible, and try to limit what the heck you have to search, both from a cost standpoint and also from a disclosure--where you're going with this thing.

From the government's standpoint, albeit my experience is dated in time, I bet it's not materially different today. Most of the young lawyers--and they are mostly young lawyers--are afraid to make cuts. They're afraid to say, you know, what? Let's pass on this. We don't need those documents. We don't have to look in that person's

files, for fear that some day, someone will come forward and say, "Aha! You didn't look in this person's file; you're not a very good lawyer," or worse.

So therein lies what I see as being the inherent conflict within the Department or the FTC dealing with this. Why, though--and this is the question I suppose I put to all of you, but particularly to Bob and Susan--why should the standard be any different than it is for any civil litigant who's issuing a Rule 34 request? You make cuts all the time. You have to make deals as to what files will be searched, because if you don't, you're probably going to end up before a judge that's going to say, "This is overly broad and too burdensome."

So why shouldn't the government, in terms of documents at least and witnesses--as you know, the Federal Rules of Civil Procedure provide you get 10 witnesses in a case, absent some showing that requires more--why shouldn't the government be held to the same standard? You have more discovery than you can imagine before you have to file a case, and then you get discovery in the case.

So why shouldn't you be held to the same standard? Bob?

MR. KRAMER: Well, this isn't civil discovery. It's discovery under extreme time pressures, and it's discovery under which we often don't really get much meaningful discovery once we file.

That doesn't mean I--I mean, I agree that that there is a lot of room here, but I'd like to fashion a system or a set of rules internal to the agency that don't affect litigation positions, don't disadvantage the government in court, and don't result in bringing too many cases or not enough cases.

So we don't want type one and type two errors as a result of how we change the Hart-Scott process, because I think most people think that with some exceptions, that's generally being done in a reasonable way.

But most cases aren't litigated, and most people aren't going to go that way. To me, that's my target audience in sense on the company side, and internally, it is giving the type of guidance to the

staff that could be very explicit in terms of numbers. You know, you could imagine guidance that documents would be obtained from X number of custodians, but if there are three product markets rather than one, you add two or three, or whatever it happens to be, per product market.

So something that gives the staff the type of direction without being completely inflexible at the same time. I think that's the proper approach.

COMMISSIONER LITVACK: I must tell you I do agree with you. I think that is the approach.

By the way, and I have two other points. One was, you made the statement in response again to Jon Jacobson's proposal here that you weren't aware of any situation in which the executive branch had to go into court to conduct an inquiry or an investigation.

I haven't done this in a long time, but, as I remember, the CID Rule was that, if you issued a CID and I didn't want to comply, you had to go to court to enforce that; am I wrong on that?

MR. KRAMER: Well, often one has to go to court to enforce some things.

COMMISSIONER LITVACK: But that's an investigation is my point.

MR. KRAMER: But that's not--but it's not the issue with CID. You don't have to go to court and get a judge to issue it.

COMMISSIONER LITVACK: But it's not self-enforcing is my point.

And if the government wants to enforce it as part of its investigation, it must get a federal judge.

MR. KRAMER: Now, of course, Hart-Scott isn't really self-enforcing either, because we have to go to court--

COMMISSIONER LITVACK: Right.

MR. KRAMER: --to block a deal, because parties always have the option of saying--

COMMISSIONER LITVACK: Okay.

MR. KRAMER: --we have, in fact, certified compliance.

COMMISSIONER LITVACK: Exactly.

MR. KRAMER: We feel we're good for this position. Come to court and stop us. We plan to merge on a particular day.

COMMISSIONER LITVACK: That's a nice segue for my last question.

MR. KRAMER: I figured it was, that you're heading that way.

COMMISSIONER LITVACK: I appreciate it. One of the things that's concerned me to the extent I have had exposure to it is, it seems to me that in the real world, put aside the 30 days and 20 days and all that--in the real world the process is such that, unless you're prepared to take a lawsuit, the process is an extended one, because the government wants to take some depositions; the government wants some more documents; the government wants to talk to some more people. And if you force a decision, you fear, perhaps with some basis, that all you're going to do is force a decision to bring a lawsuit.

And so, while, as you say, Bob, people sort of know that maybe they will; maybe they won't, hope beats eternal. The client always believes, the lawyer believes if I just can have just another meeting, another opportunity, I have a chance to save this.

And I am wondering whether there isn't

pressure, and it came up when Mark was talking about--he raised in my mind when we were talking about the first 30 days and the parties agreeing--in response to something Debra asked I guess--to extend it. And Mark said, "I'm afraid there would be subtle forms of pressure or whatever to always extend."

And I think that's what we have now, and I guess my question is, do you see that, or am I just seeing a very small slice of the pie? Well, I know I'm seeing a small slice of the pie, but--

MR. KRAMER: Well, everybody always sees a slice of the pie, and we do as well.

COMMISSIONER LITVACK: But is this an issue?

MR. KRAMER: I think it's fair to say that, at any particular time, if we have to make a decision on day X, and there are certain issues that are possibly outstanding, and they could benefit from further discussion or further empirical work, but we have to make a decision on that day, there are times when you'll want to make the decision to go after a deal rather than to let it go, because our core mission is to protect consumers from anticompetitive deals.

I think in a large number of cases--and this is why people give the agencies more time I think, not just because of false hopes, but because of hopes that are informed by their experience--that taking the time and having discussions with the front office over some period of time or discussing the econometric work or other empirical work is to the benefit of parties.

And I think that's why people do it.

I don't know if I've answered your entire question.

COMMISSIONER LITVACK: No. I think you have. I guess--what I was going to ask you or anyone is, are these decisions, which obviously are made by the putative defendant or the defense counsel to extend, but the request usually comes from a suggestion--it usually comes from the government--are they decisions typically made by what I will call senior management?

MR. KRAMER: Well, I think that senior management (A) encourages scheduling agreements, and you see that in the Merger Review Process Initiative: and (B), specifically has to approve any scheduling

agreement. I mean, basically a deputy and I both have to approve a scheduling agreement before it's going to be entered into.

Once you're in the end phase, meetings with the front office--typically the timing decisions are driven by the front office and not by the staff at that point.

COMMISSIONER LITVACK: Okay. Thank you. I appreciate it.

CHAIRPERSON GARZA: Commissioner Kempf.

COMMISSIONER KEMPF: Two things. First, the process of reforming what I think, there's a consensus, is broken, I would encourage the agencies to think about what I'll call trial balloons, putting it--in other words, not waiting 'til you have the Holy Grail in hand and then saying, "Aha! We've cured everything," and announcing it, but rather, taking suggestions that such has been offered today and the course of testimony previously and in the writings, *et cetera*, and just letting our--say, "Hey, we're thinking of this. You know, what's the reaction of"--or soliciting comments or something like that, rather than seeking a counsel of

perfection for the instance.

And secondly, I'm concerned about how long it takes. I'm reminded of the old story that when Ross Perot was on the General Motors Board, he asked how long it would take to develop a new car they were working on, which I think was the Saturn, and he was told it would take five years. And he said, "It really can't take that long."

Well, and they said, "Yeah, it's going to take five years." And he said, "You know, World War II, from start to finish, didn't take that long, and, you know, it's not that hard." And that's sort of my reaction to this thing or some things that are broken and are in need of repair, and I would think something that expedites this process, if only in the form of trial balloons that people could start reacting to, would be beneficial.

Second--and it's picking up on what Commissioner Litvack was asking about. It's what I call "the call,"" and that is, you've done your second request, and you get this call that says, you know, "We really would like more time to study this, and if you won't give us more time, we'll make a

decision, but, gosh, who knows how that decision is going to be." And it usually sounds like it's ominous. It's not threatening, but it sounds ominous and perhaps not as well informed as you or as a defense counsel would like it to be.

And, more often than not, the additional time is granted, and too often it becomes a--it goes from a regime where these tight time frames to one where there is no time frame, and the *FTC Watch* publishes each issue the scorecard of things that have gone on instead of 30 days for 30 years or so it seems.

And the party does, as Commissioner Litvack said, always have a chance to assess the request and to decide whether to grant it or not. And sometimes the calculus you're going through is well, why did they say they need this? And usually, in my experience, it's to get more time to evaluate information from third parties, because it's newer to the table.

But sometimes, you know, you're saying to yourself, "Gee, I think if we have one more meeting, we can persuade them." Other times, you're saying to

yourself that you're never going to persuade these people, and this is not a search for more information to evaluate; this is a desire to buy additional time to better perfect their record in bringing the PI case. And sometimes you have to make the hard decision that says, "No, I'm not going to do that. They're going to sue us anyway. Let's just tell them there is no more time." And sometimes they sue and sometimes they don't.

And sometimes you can understand the rationale for more information, and sometimes it's a little bit more difficult.

But I'm concerned that something that Congress said--here's what strikes us as a reasonable time frame within which to complete this task, becomes something that is 10 times what Congress had in mind, when they were doing it. And I think the one thing I would encourage the agencies to do would be to think about ways internally that this, what I'll call "extra process" procedure, can be avoided. In other words, it's a consensual thing that occurs outside the process when the two parties say, "Okay, we'll extend it 'til doomsday."

But that's not a good thing either, with respect to the process, and I don't really think, as in some of these cases, it takes two years to come to an informed decision.

Does anybody, especially at the agencies, want to comment on that?

MS. CREIGHTON: I would agree that it usually doesn't take two years to reach a decision.

With respect to the counsel of perfection, I agree with you that this is definitely an iterative process, as I think the Chairman indicated when she announced at the last Fall Forum that she wanted us to undertake a serious review of our process. I expect that we're going to have some results to be going forward with in the relatively near future. But there are others that are in the works; it's not going to be a one-time thing. And my guess is, we're going to see how it works, and, if we didn't balance it right, we'll have to take a further look at it, because it is extremely important for consumers, not only that we're doing a good job in evaluating mergers on the merits, but also that we allow procompetitive mergers to go through on a timely

basis so that consumers get the benefit of efficient transactions as soon as possible.

So I agree that the merger process is not something we should wait on until we think we've got it exactly right.

With respect to the question of, where did the request for extra time come from, clearly, it's something that we're focused on. An important issue that I think has been underlying a number of questions and comments today has been the importance of having senior management involvement in the second-request process, really from the get-go. We've been having deputies meeting with teams early on, at the beginning of the second-request process and continues thereafter on a very frequent basis. That's something new, and we're trying it, and we'll see how effective it is.

In terms of really focusing on what are the key issues in the case, since we'd be the plaintiff in any case, all we have to do is find one dropped stitch, and we're done. So if entry is the thing that would keep us from bringing a case, let's focus on that, and try to be aggressively pushing towards

closure where we can.

That said, there are hard cases where there isn't any ready fix, and it's a hard question, whether to bring a challenge or not, and sometimes that's where the requests for additional time come from, there is not a consensus among the decision-makers. Obviously, parties have the right to say, "I'm going to roll the dice and hope that ultimately, under the press of time, the decision-makers decide if in doubt, don't." But I think the request is coming often from the senior staff or, in our case, the Commissioners, who are trying to reach a decision on the merits.

COMMISSIONER KEMPF: Bob?

MR. KRAMER: I agree completely that those additional requests for time, or more time, really are not viewed as a sort of tactical move to obtain let's say the last declaration or to make a court paper a little bit better. It's because the decision-makers really take seriously the obligation only to bring cases that should be brought. And while decision-making can be made in a short time period, whether it's 30 days or 40 days or 50 days,

it may not be the best decision-making. And sometimes, coming to the right result takes more time than the parties would like. Now, that doesn't mean a 200-day decision, but, you know, looking back over our statistics, I don't see that. Things don't often take that long.

And I see substantial decreases in the amount of time that it has taken to conduct investigations, whether they're PIs that have closed, or whether they're second requests that end up closing. Right now, this last year, the average second-request investigation lasted about three months and something like--I put some updated numbers in my testimony, from the written testimony, but nine of the 15 second requests did not go to full compliance; that staff reached ways with counsel to focus investigations on particular issues, get particular types of documents first and avoid the full burden of the second request.

So I think that we're seriously trying to limit the amount of time that the investigations take and to get out of the way of ones that we think are not going to be problems and do that more efficiently

and effectively than we have in the past.

But on those ones that go longer, I think it's clear that it's because decision-makers are struggling with doing the right thing.

COMMISSIONER KEMPF: Thank you.

CHAIRPERSON GARZA: Okay. Commissioner Carlton.

COMMISSIONER CARLTON: I don't have--I think one quick question just to follow up on what you--what Mr. Kramer was saying.

Isn't the speed with which you do something going to depend on how much staff you have? And, therefore, I guess my question is, if companies are complaining things aren't getting done quick enough, is that another way of saying that you should have more staff? And then the question is, who should pay for it, and how should it be paid?

Should a company that wants an expedited request pay extra? I mean, what do you think of that, and also, I'd be interested in what Susan thinks of that.

MR. KRAMER: Well, that's certainly a market mechanism, but I think ultimately we'll defer to

Congress as to exactly how we--how our budget gets set and how it gets paid.

Doing it faster has some interesting, I think, issues, because if you have--if you assume that the demand for mergers has nothing to do with how quick a review is, to the extent that we do a review quickly, it means that we--the resources that are limited are available to work on something else.

So I think, on average, you can actually--staff matters more deeply if you have a commitment to running them quickly and getting rid of--ending investigations, closing investigations that aren't going anywhere.

MS. CREIGHTON: Commissioner, I think you can probably appreciate sometimes it's not just how many people you have, but there are bottlenecks, and economics is an important bottleneck. So, for example, parties often find it very difficult to get data produced to us up until the very last moment, and then turn around and say, "Okay, now make a decision in two weeks or three weeks." And it can be difficult for our economists to put together results that they're confident of in that short time frame.

There's further follow-up they want to engage in, for example. And so we find ourselves very much pressed up against the wall with respect to what we often view as indispensable information to make the right decision.

COMMISSIONER CARLTON: Okay. Thank you. I'll just point out the University of Chicago has a lot of very good graduate students this year in Economics, so--

[Laughter.]

CHAIRPERSON GARZA: Commissioner Warden.

COMMISSIONER WARDEN: Thank you. Well, everyone agrees that there's a problem here, and I agree myself with the comment that it's gotten worse with electronic storage.

But I think it's been a generally acknowledged problem for at least 10 years, and there have been efforts to do things about it. And I appreciate the present efforts that you all have testified to, and the good faith with which they're being undertaken.

I also appreciate the comment that there is the one-product market merger and the 20-product

market merger.

But I must say I despair of this problem's ever being resolved without the imposition by the agencies internally, of quantitative limits, whether they be in terms of who's searched or how far down you can go. That could vary, according to the complexity of the transaction. But without those limits and without a firm policy not to depart from them, absent extraordinary cause, I don't think this problem will ever be solved.

Now, does anyone disagree with that?

Thank you. I appreciate that.

You do?

MR. COLLINS: Commissioner, if I could. I actually disagree with it. Okay.

And I think--here's the problem, and actually it goes exactly to what Commissioner Litvack was saying.

There actually is a mechanism right now to do almost everything that Sandy wants to be done. The interesting thing is that nobody knows it exists, but it's inherent in the structure of the Hart-Scott-Rodino Act.

The way the Hart-Scott-Rodino Act works is 7A(e)(2) states that your end--the time starts running for the end of the waiting period once you put in whatever you put in and put in a statement of reasons for non-compliance. It has nothing to do with substantial compliance.

Substantial compliance only appears in 7A(g)(2), and that's the factual predicate which a court must find in order to enter an order to compel the parties to produce additional information, and to extend time if the court finds that basically in the public interest.

So the parties actually can put this question to the court any time they want to, by just producing for five people, putting in a statement of reasons for non-compliance, which I think is terribly misunderstood both by the bar and the agencies, and then flipping the question in the court.

And then I think what you do is find Article Three judges basically applying federal rule standards. And I think that this will work quite well.

COMMISSIONER WARDEN: So we didn't even need

to have this hearing, according to you?

MR. COLLINS: Well, I think--

COMMISSIONER WARDEN: People have been operating under a cloud of ignorance all these years?

MR. COLLINS: That's right. And let me tell you what--then the problem is two-fold actually. One on the part of the agencies: the agencies take the view--and I think the bar has bought into it, to a very deleterious effect--that substantial compliance is actually the condition that you need to satisfy in order to start the running of the waiting period.

Now, the deleterious effect is that the bar--I think large portions of the bar have taken the view that, if that is the standard, then they don't need to put in a statement of reasons for non-compliance on things that don't amount to substantial compliance. And I think that you will find a large number of second requests being produced that are certified without a standard, without a statement of reasons for non-compliance that do not satisfy the requirements of 7A(e)(2).

COMMISSIONER JACOBSON: How often have you litigated that?

MR. COLLINS: We actually tried to once.

[Laughter.]

COMMISSIONER JACOBSON: But aren't the institutional pressures such that you just can't do it? I mean, is that a practical solution to the problem?

MR. COLLINS: I think it is a practical solution, but what it does is it takes--like all the questions that we've been discussing here--it basically takes a willingness of the agencies to subject themselves to some judicial review.

I mean, I think, actually, if--I think the agencies should be much more willing to go to court, and I think they should be much more willing, quite frankly, to either win or lose if they're in court.

You know, one of the things you observe, for example, is in the CID statute, as Commissioner Litvack pointed out. The CID statute is not self-executing, alright? You hardly ever see enforcement actions on the CID statutes, and you also don't see overwhelmingly burdensome third-party CIDs out there either. And the question is, why?

And I think the answer is that the realistic

threat of finding themselves in court, on both sides, actually does temper considerably the burden, if you will, of those CIDs. And I think, on the second request, if the agencies were willing to come up and basically say, "Look, the standard is not whether you substantially comply, that's for us to determine as a prosecutorial matter in the first instance." And then to go seek a court order if we think there hasn't been substantial compliance and convince a court that there hasn't been, and what you would find would be that your requirements to the second request would drop considerably. You would find that you don't need to produce the usual 80 to 120 people of custodians, because the judges just aren't going to say, "That's enough." I mean, "That's too much." They're going to say, "You know, you can do it with a lot less," because what the question should be before the court on substantial compliance is, is there information that is missing which the statement of reasons of non-compliance should have identified that is missing that is materially incrementally probative to the merits of the case.

And, you know, I think the answer is going

to be that what practitioners will do is fashion their second-request responses to make that showing exceedingly difficult on the part of the agencies and not produce a whole lot of documents.

CHAIRPERSON GARZA: I'm going to refer this to Commissioner Warden. That's--let him--give him a little bit more time and let him follow up.

COMMISSIONER WARDEN: That's very interesting, and it's obviously a hypothesis, because nobody has been doing this, as you yourself say.

I have two questions. One is, why hasn't anyone been doing it? And the second is, do the other members of the panel agree that this is the magic solution to the problem that we've been discussing here today?

MR. COLLINS: Well, let me answer the question why people aren't doing it.

Actually, some people are doing it. But what--are doing the following: They are taking the position that they put in whatever they put in, and a complete statement of reasons for non-compliance, and take the position that the time is running.

And one thing that happens is that, if you

take that position, you will find an enormous amount of hostility on the part of the agency, you know, toward that position. And that can have some adverse effects unless you're willing to litigate.

Now, if you happen to be willing to litigate, it turns out your second requests are not overwhelmingly burdensome, and you usually get pretty good results; that's point number one.

Point number two is, I think, that there has been--a culture basically has to develop that says that substantial compliance is the trigger for the running of time, and that is what the agencies have been saying for basically the last 20 years. And I think the bar has largely bought into that, and I think that, as a result, you don't get the technical statement of reasons for non-compliance, nor do you get a lot of--I mean you don't see people taking the approaches that I've just outlined.

COMMISSIONER WARDEN: Okay. The other members of the panel, do you all agree that he's found the Holy Grail here, and we can all go home?

MR. KRAMER: I don't think it's any particular Holy Grail to anything actually. I think

that there are issues, and I've gone over a number of the issues that there actually are, including the increased numbers of documents. Second requests where you used to get hundreds of boxes, we get thousands now. I mean, there's one matter where we received 24 million pages, even though we were actually trying not to, but the search was done beforehand I think, before the second request. The search was in response to the hypothetical and negotiated second request as opposed to the actual second request.

But, I'm not saying there aren't problems like that. I've not seen substantial compliance being the big issue. I think it's sort of like the--it's like the Cold War on second-request compliance. No one wants to go to court, because no one wants to take the risk. The parties don't want to be shot down by a court and told that they can't go ahead, and they have to go and delay it and bring more documents in. And the government, if the government loses that motion, you know, the parties just go forward with the deal unless they can get a very quick TRO on the merits together.

So there is a sort of, you know, situation in which everybody has nuclear arms--no one does anything nasty, and it usually works out.

We have litigated no substantial compliance issue since the Act was passed at the Department.

So, to us, we don't see substantial compliance--

COMMISSIONER WARDEN: How about these statements for--how about these reasons for non-compliance? Have you ever litigated one of those?

MR. KRAMER: I haven't litigated one of those either.

MS. CREIGHTON: The Commission did recently bring a (g)(2) action, and I think, in that case, articulated a different understanding of 7A(e)(1)(A) than Mr. Collins has. What the statute says is you have to produce in compliance, and [16 C.F.R.] 803.3 says you then have to then provide reasons for non-compliance--why you were unable to produce, not why you chose not to produce. Though obviously, any party would be free to challenge that regulation as an abuse of our discretion.

But I did want to go back, Commissioner, to your initial point about the importance of reducing the number of custodians, which, as I've said and will reiterate, is obviously a core feature of what we're looking at.

I do think, though, that there are a number of other issues that are presenting a challenge for us in terms of trying to keep these document productions from getting wildly out of control. I think I mentioned in my written testimony that the number of boxes from a recent custodian had gone from four in 2000 to 140 in 2005. I just did some quick math, which is probably wrong, but I think that means that, even if we had 25 custodians that we searched, we've now got 3,500 boxes, which would have been considered quite a large production not all that long ago.

So obviously, it can't be that the only thing that we do is just keep on reducing the number of custodians, because I'm afraid the number of boxes per custodian is going to keep on expanding. So that's one of the reasons we're looking at a number of other things--the number of years, for example,

and other ways of reducing the sheer volume of data that's being kept or being produced for us.

COMMISSIONER WARDEN: Thank you.

MS. CREIGHTON: Thank you.

CHAIRPERSON GARZA: Well, I'd like to take the opportunity to--one more question? Okay. I won't finish my sentence. Okay. All right. Commissioner Litvack, if you have a quick question.

COMMISSIONER VALENTINE: Oh, we're not starting at the top again? We're--

CHAIRPERSON GARZA: Well, I was going to--what I was going to say is, we have the opportunity to end this a little early for those who want to go back to New York, but I was going to ask if any Commissioner wanted to ask another question, and I see Mr. Litvack does.

COMMISSIONER KEMPF: I do, too.

CHAIRPERSON GARZA: Okay. Well, then there goes that.

So then, we will start from the top.

MR. WHITENER: There's always the 6:00 shuttle.

CHAIRPERSON GARZA: If you all can keep the

questions and the answers short--then, since, Debra, I take it you have a question, and you were at the top, so we'll go back to you first.

COMMISSIONER VALENTINE: You can go if you want to. No, you can go if you want to.

Two quick questions, and I think the answers can be pretty quick, too.

First, it was a very hot issue a couple of years ago that we ought to put a time limit on second-request periods, like we should be done in four months, let's say.

I haven't heard that proposal, and there are certainly reasons why suddenly having a time crash down might actually lead to false positives, but I'd be interested in each panelist's brief reaction as to whether that would be one other way to control the second-request process. So just--you've got to be done by X date.

And the second issue--and this is, I think, more for the agencies. Susan, you alluded several times to the issue about economic data and getting the right economic data as we get into more sophisticated analyses, and I agree totally with you.

That's a serious issue, which I think is probably gotten differently than by searching files of thousands of people over 10 years.

One of the things that came up this morning was that, often, the economists' analyses come out at the last minute and cannot be fully shared with the parties, because you've relied on data from third parties.

Is there any way that you can condition how you get your data from third parties so that it can be shared either with outside experts for the parties or outside counsel for the parties or aggregated or anonymized in some way so that there can be more productive and constructive discussions that go on around what the economic data is showing?

MR. WHITENER: Well, I will address the timing question. I think I alluded to it before.

I think the deadlines in Europe make a lot of sense for the European system.

I think the deadlines in the U.S. make a lot of sense for our system. We have deadlines, and the key variable is the time it takes to respond to the second request.

So I think if we can come up with some reasonable ways that everybody can live with to reduce the second-request burden, then the whole process moves on a pretty good time track here.

MR. WALES: What I would say is, in Europe, as you know, there are few documents involved, and so those time periods are set with a different constraint on them. What I would say is that, in the U.S. you have, obviously, the incentive of the parties to get the deal done, and so I think, without question you have clients who are going to get through that second-request process as quickly as they can. I think constraints on how quickly they do that in the U.S. would only add to the burden unless you have some obvious lessening of the second-request burden itself.

MR. KRAMER: Over the last three years, the average second-request investigation that ends up getting closed as opposed to the one where we file a lawsuit, has been between three and five months, depending on the year.

So it hasn't been excessively long. And that--so for the average case, putting aside any

outlier, the average case that's not been a real issue that we've seen.

On the data request, I mean obviously sometimes there are cases where the data can be shared because you're using the common source--scanner data, for example.

In the other cases, it's obtained through CID, and we have the problem of convincing people to give it to us quickly and without taking us to court. There are people who are concerned typically about the confidentiality of their data. There is a real issue about whether it would affect our ability to get information if we were actually turning over confidential third-party information at that point.

The workaround--and it's a workaround--tends to be for the economists to go through the type of model we're using and what the assumptions are, and, you know, what the key variables are and what parameters are being used, and things like--and discuss it more at that sort of economic level as opposed to the actual data. Now, that is totally a workaround, but we do have the concern about whether we're going to be able to get documents from parties.

You know, and it doesn't help when--sometimes district courts want to allow inside counsel in a litigation to look at key company documents. I mean, that's been a big issue recently.

COMMISSIONER VALENTINE: And including said counsel. But, Susan.

MS. CREIGHTON: Well, on the time frame issue, I would say that, so long as we base most of our analysis on documents, I would still support having the time frames be triggered off of that production. Clearly, we could go to a very different system, where we went back towards more presumptions based strictly on concentration levels, for example. We could have much shorter investigations if we did that. But I wouldn't advise that, and so under the current approach, which is one I endorse, I would not change the time frame being triggered off of document production.

As to ways to try to better share the data that our economists have, I agree that that's an issue. For us, transparency is a very important goal to be striving towards, and it's definitely the case that there have been times when, because we aren't

able to share the data that we have access to, there is a real asymmetry between what the parties think we have and what we actually have, and that's not ideal.

But I'm afraid I share some of Bob's concerns about--the practical limits on our ability to solve that problem.

MR. COLLINS: In my experience, the sharing of the data is not the real problem, although I'd love to be able to get the data. I think the two things I would rather have before I got the data would be the specifications in the models that the FTC was using or the Justice Department was using, and I will tell you--well, let me say that.

And the second thing I would like to know would be what their results were. Okay? Basically, the estimates that the models are producing, which I don't think, in most cases, people have a problem with being shared, at least under the confidentiality statutes.

So I want to see the specifications, and I want to see the estimates, you know, of the model.

Then I would love to be able to get the data. But, you know, chances are, in most of these

cases, right, we're going to have enough data--the parties are going to have enough data to be able to at least run those specifications and see whether or not we're getting something dramatically different than what the agency is.

Now, but if needing the data, which I think would be an absolutely fine idea--I mean one way to handle this problem, which I think avoids the confidentiality problem, is the agency goes out and they hire a consultant. Okay? The consultant basically is the one who runs the models, and the parties can then specify the models they want run. Okay? The parties don't have to see the data, but they get--they put in their specifications of the models, and they get their results out.

I don't think that runs into any confidentiality problems.

COMMISSIONER VALENTINE: Interesting.

Bob, I have a quick question for you. The--you've mentioned that, this year the average second-request investigation has taken three months, which really kind of surprised me. I take it that's from the issuance of the second request to the

closing of the investigation.

MR. KRAMER: That's from the opening of the PI--

COMMISSIONER VALENTINE: Mm hmm.

MR. KRAMER: And I think it's in large part due to the fact that, remember I said that nine of the 15 second requests only resulted in either no or partial production, which means that staff is being pressed throughout--even after the investigation begins--after that second request goes out to make cuts on matters that aren't going to be anticompetitive or to reach, for example, quick-look agreements with parties to look at discrete issues, which is all part of the Merger Review Process Initiative?

We think that one of the reasons that the length of the investigation has dropped is that quick-look investigations are becoming more common and that staffs really are being pushed to both utilize them. I guess a good example of that is the exchange mergers, on which we put out a closing statement yesterday, which was, predicated on the issue of entry. We decided that entry was a

dispositive issue. We focused the investigation on entry. It got done quicker than it would have if it had been the full investigation.

If you spread that across a large number of investigations where second requests go out, on average you end up having shorter investigations, because you start culling out matters more quickly than before. It would have taken longer if you had just waited for a second request production and gone through all the documents.

So I think--we've made some progress simply using the tools in place. So, we're looking at ways of reducing the burden for those that go all the way to a second request.

But in the last year at least, that's been increasingly less common to go all the way to a second request for full production.

CHAIRPERSON GARZA: And now, the 15--did you say it was 15 investigations? How many of those involved pulling and refiling?

MR. KRAMER: I'm not sure. I can tell you that pulling and refiling happens in a significant number of PIs, but those wouldn't have been in that

particular number, because those often don't get second requests. I think 60 percent of the time in our recent experience, pull-refilers don't receive second requests.

CHAIRPERSON GARZA: Okay. Thank you. Commissioner Litvack, you had a follow-up question.

COMMISSIONER LITVACK: Yeah. I'll be very quick. As much as I would be attracted to the notion of a fixed time frame in which an investigation had to be completed, don't you think that from the government's standpoint that would be troublesome in that, if the incentive on the defense side or the would-be defense side is to just play it to the end--you can give the documents at the end. Two days before, all of a sudden the documents show up, or whatever it may be, and there's no other outside enforcement in this process; isn't that going to be terribly disadvantageous to the government? I mean, wholly apart from your claim that there's no need for it, it would be affirmatively bad; am I correct?

MR. KRAMER: I think it could have a lot of gaming abuses something like that, as you've described.

COMMISSIONER LITVACK: And I guess just one last comment. I was somewhat cheered by Dale's suggestion. I did, by the way, once as a private practitioner, bring a suit against the government to have a CID stricken. Rather than waiting for the government to sue us, we sued the government.

In any event, it would seem to me that you're going to, even taking Dale's route, end up at most or at best in court in a big argument about what would happen, and your time may or may not be running, and you're proceeding at your own risk.

Therefore, where I come out as a result of listening to all this is that, to the extent this Commission can agree upon a recommended process or procedure for the agencies to implement, consistent with whatever it is you're going to propose yourself, that is probably the best hope we have for dealing with what we all agree is a problem.

CHAIRPERSON GARZA: Mr. Kempf, did you have a--?

COMMISSIONER KEMPF: Yes, I did. Just one subject, and it grew out of a late comment by Mr. Kramer.

In your prepared remarks and most of the discussion, the focus was on limitations, whether custodians, number of documents, whatever, that--and the statements were, "Gee, that ought to be enough to do a good investigation."

My comment, Bob, and question arises out of your thing late in the day where you said you had one--recently, where you got 24 million documents. And it's sort of the flip-side.

I would think that receipt--while you need to have enough to do an adequate job, I would think that receipt of 24 million documents would lead to less effective enforcement than some reasonable number.

Could you comment on that?

MR. KRAMER: I think that large productions are a problem. At least one mitigating factor is that, in some matters, to the extent that they're electronic productions, they can be searched using search terms, and then the actual physical, you know, reading specific documents line-by-line is limited.

But it is a problem. It is a resource issue for us. Staffs that are expecting very large second

requests have to be much larger. We view it as a problem for us, as well as for the parties, having huge second-request production.

MS. CREIGHTON: I agree completely, that as a matter of good government, we don't want to be asking for documents that are irrelevant or unnecessary. Not only does it slow down the production process, but simply from the perspective of doing our jobs, it's also a problem. We have to find computers to store the documents on. We have to find staff to review them, and it makes it that much harder to find the important documents.

MR. KRAMER: Now, that number, obviously, is an outlier, even among large ones today. Thank goodness.

COMMISSIONER KEMPF: That's all I have.

CHAIRPERSON GARZA: All right. Well, thank you very much to the panel again for appearing here today, for your thoughtful comments, and for your written statements. We appreciate it, and it's conceivable we'll get back to you with follow up.

I hope you'll be open to responding and also hope that you'll remain interested in the activities

of the Commission. Thank you very much.

[Whereupon, at 5:01 p.m., the hearing was adjourned.]